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LEGISLATIVE ASSEMBLY

1980

THE INSURANCE INDUSTRY  
FOURTH REPORT ON  
LIFE INSURANCE

THE SELECT COMMITTEE  
ON  
COMPANY LAW

Tabled in the Legislative Assembly  
by

JAMES R. BREITHAUP, Q.C., M.P.P.  
CHAIRMAN

Fourth Session, 31st Parliament, 28 ELIZABETH II





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T Report

The Honourable John E. Stokes, M.P.P.,  
Speaker of the Legislative Assembly of  
the Province of Ontario.

Sir:

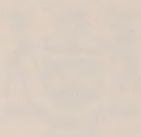
The Select Committee on Company Law has now the honour to submit its  
Fourth Report on life insurance.

A handwritten signature in dark ink, appearing to read 'J. R. Breithaupt', with a long horizontal flourish extending to the left.

J. R. Breithaupt, Q.C., M.P.P.  
Chairman

June 1980.

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## PREFACE

The Select Committee on Company Law was reconstituted on May 25, 1976 under the following terms of reference:

“to continue the enquiry and review of the law affecting the Corporations in this province as reported on by the Select Committee of this House appointed on June 22, 1965 and re-appointed on July 8, 1966, on July 23, 1968 and December 17, 1971 and to, in particular, enquire into and review the law relating to the business of insurance companies in the province including, but not restricted to,

- (a) the incorporation, licensing, regulation and supervision of insurers as joint stock companies, mutual corporations, fraternal societies, mutual benefit societies, exchanges, syndicates of underwriters and rating bureaus carrying on all classes of insurance business in this province, mergers, amalgamations and reinsurance of liabilities, reporting to shareholders, policyholders and members, their solvency, liquidity and financial requirements, the purposes, scope and functions of their returns, reports, statistical gathering, and the basis for their rates and premiums;
- (b) automobile insurance contracts and, in particular, the provision of accident benefits, fire insurance, accident and sickness and marine contracts and generally insurance contracts in this province;
- (c) the licensing, regulation and supervision of insurance agents, brokers and adjusters; and
- (d) the marketing of insurance in this province.

And that the Select Committee have authority to sit during recesses and the interval between Sessions and have full power and authority to employ counsel and such other personnel as may be deemed advisable and to hold meetings and hearings in such places as the Committee may deem advisable and to call for persons, papers and things and to examine witnesses under oath, and the Assembly doth command and compel attendance before the said Select Committee of such persons and the production of such papers and things as the Committee may deem necessary for any of its proceedings and deliberations, for which the Honourable the Speaker may issue his warrant or warrants.”

In order to examine the business of the insurance industry in this Province with reasonable care and thoroughness, the Committee has segmented its investigations into several fields of study. It was agreed to focus first on the field of general insurance and enquiry into this industry area resulted in the issue of three reports, two on automobile insurance and one into the remainder of the general insurance field.



The Committee's First Report on Automobile Insurance was submitted to the Legislative Assembly on March 28, 1977 by the Chairman, Mr. Vernon M. Singer, Q.C. The Second Report on Automobile Insurance was tabled in the following year on June 22, 1978 by the newly appointed Chairman, Mr. James R. Breithaupt, Q.C. Mr. Breithaupt tabled the Third Report on General Insurance on June 12, 1979.

On July 10, 1979, the Committee was reconstituted to conduct enquiry into the life insurance field and resumed its hearings with the following fourteen appointed members: Mr. Breithaupt (Chairman), Messrs. Blundy, Cunningham, Germa, Handleman, Hodgson, Laughren, MacBeth, Reid, Renwick, Rotenberg, Smith, Van Horne and Yakabuski. Mr. S. Handleman resigned from the Committee and Mr. G. Taylor was appointed on December 20, 1979 to fill in the resulting vacancy.

For its current sessions the Committee agreed to focus upon the life insurance business and defer study of accident and sickness insurance until a later date. In consultation with the Office of the Superintendent of Insurance and the Canadian Life Insurance Association, the Committee reached the conclusion that enquiry into accident and sickness insurance would require detailed and separate consideration.

The Committee approached its most recent investigations through a series of public sessions. During the course of its hearings the Committee learned from consumers, the industry, the Superintendent of Insurance and others interested in insurance matters of concerns regarding the laws and practices related to the business of life insurance.

The Committee is most grateful to those persons who came to express the consumer point of view. Mrs. Helen Anderson and Mrs. Marian Kramer of the Consumers' Association of Canada, Mr. Albert Lam, P. Eng., Prof. Reuben A. Hasson, Ms. Marie Corbett, LL.B., The Canadian University Teachers Association and the Ontario Confederation of Faculty Associations, are thanked for their time and effort in bringing their concerns before the Committee. Appreciation is also extended to Mr. William McLeod, Professor of Business Administration, Cambrian College, who provided the Committee with a consumerist's view of life insurance and acted as a consultant to the Committee for a two week period of its hearings. In addition the Committee received several written submissions outlining consumer concerns.

The Committee approached the first part of its meetings with industry representatives as fact-finding sessions. The first three and a half days of the Committee's sessions in July 1979 were devoted to an overview presentation of the life insurance industry prepared by The Canadian Life Insurance Association. Additional informational sessions were held during and into early August, 1979. These sessions included visits to life insurance companies in Waterloo and London, Ontario and meetings with the Life Underwriters Association of Canada in Toronto.

It was the intention of the Committee in these sessions to assemble, from various perspectives, sufficient information on the many components of the industry to allow the Committee to obtain a thorough understanding of the operations of the industry and to identify possible problems or concerns of both insureds and participants in the industry.

The Committee continued its enquiry in September and had the opportunity to question various participants in the insurance industry on the way they carry on their business. Also in September, the Committee travelled to Hartford, Connecticut for fact-finding meetings regarding the United States life insurance environment, and met with representatives of the American Council of Life Insurance, the Hartford C.L.U. chapter, the Aetna Life and Casualty Insurance Co., the Travelers Insurance Co., Life Insurance Marketing and Research Association, the Medical Information Bureau, the Hon. Joseph C. Mike, Insurance Commissioner in the Connecticut Department of Insurance, and, additionally, with members of the Connecticut state legislature at an evening reception. The Committee also welcomed the opportunity during its sessions to attend the Conference of the Association of Superintendents of Insurance of the Provinces of Canada in Moncton, New Brunswick.

In January 1980, the Committee was pleased to learn more about developments in the United States regarding life insurance regulation and about continuing consumer concerns from the following persons: Mr. Spencer Kimball, Counsel, American Bar Foundation; Mr. Robert E. Dineen, Consultant, National Association of Insurance Commissioners; Messrs. David C. Fix, Attorney, and Michael Lynch, Economist, staff to the Federal Trade Commission on a major study into life insurance cost disclosure; and Dr. Joseph Belth, Professor at the School of Business, Indiana University.

Since its most recent reconstitution, the Committee has held public sessions on 36 days. There have been over 140 witnesses before the Committee to discuss the operations of the life insurance industry. A list of witnesses is set out in Appendix A. The Committee expresses its indebtedness to all those who contributed to the presentations at public hearings and to the submissions, exhibits and other documents received by the Committee during its enquiry. The Committee also extends its gratitude to those companies, associations and individuals who made arrangements for the Committee to visit their premises. Special thanks is extended to the Aetna Life Insurance Company of Hartford, Connecticut for assisting the Committee in an overview of life insurance regulation in the United States. With the assistance of the many witnesses appearing before the Committee, members were able to obtain a broad perspective on the operations of the life insurance industry.

Appreciation is further extended to Mr. Rolf Drielsma, who provided the Committee with access to his collection of materials on cost comparison of life insurance products.



In addition to those who appeared before the Committee our business consultants, Woods Gordon, contacted numerous other persons asking for their assistance in the Committee's investigations and in research work.

As in all its previous studies in the insurance industry, the Committee is very much indebted to Mr. Murray A. Thompson, Q.C., Superintendent of Insurance of Ontario, for his contributions in assisting the Committee and to the following individuals in the Office of the Superintendent of Insurance: Mr. Lear P. Wood, Former Director of Insurance Services; Mr. Michael Doherty, Former Registrar of Agents, Brokers and Adjusters; Mr. D. G. Triantis, Corporate Licensing Research Officer; Mr. Brian D. Newton, Senior Actuary; and Mr. Faz Rahman, Actuary.

The work of the Committee could not have been accomplished so effectively without the assistance of our consultants, Woods Gordon, who contributed greatly to the preparation of our previous reports and to our Fourth Report. The Committee wish to express their thanks to Mr. R. Paul Boddy, C.A. and to Miss Ludmila Jagiellicz, M.B.A., representatives of Woods Gordon, for their assistance in the organization of hearings and in the writing of this Report.

The Committee's special gratitude goes to Mrs. Frances Nokes, who has been the Clerk of the Select Committee since it was first appointed. She has been ably assisted by our secretary, Ms. Rose Schmalz and by Mrs. Frances Davidson. Our gratitude is also due to Mrs. Carol Hallman and to Miss Mary Bierema of Woods Gordon who helped so ably with the typing involved in publication of this Report and to Miss Beth Cawker of John Deyell Company who coordinated so efficiently the printing of the Report.

It is the Committee's intention to continue its studies under its terms of reference: to submit a subsequent report on accident and sickness insurance and to report on various outstanding matters regarding the law affecting Corporations in this Province, including the subject of corporations without share capital.



PROVINCE OF ONTARIO  
LEGISLATIVE ASSEMBLY  
SELECT COMMITTEE ON COMPANY LAW

THE INSURANCE INDUSTRY  
FOURTH REPORT ON  
LIFE INSURANCE

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the present system of regulation of the life insurance industry. Chapter 1 sets out the Committee's general views on the topic of the public interest in life insurance and thus provides a necessary introduction to the Committee's conclusions and recommendations throughout this Report. Chapters 2 and 3 review respectively the life insurance market in this Province and in Canada and the legislation and supervision pertaining to this market. These background Chapters illustrate the role of the life insurance industry in the financial protection system in Canada, providing an introductory review of the products sold by the industry, summarizing data concerning the present structure and operations of the industry and outlining the history and current framework of the regulation of life insurance companies in this country and in this Province.

*In Part II*, the Committee turns to the sizeable task of studying *life insurance products and coverage*. Part II is divided into three Chapters: Chapter 4 dealing with life insurance products which provide death benefits; Chapter 5 commenting on annuities and individual retirement plans; and Chapter 6 examining group life insurance and pensions. Within this division of market segments is a wide range of product types and options sold by the life insurance industry and a wide range of considerations brought to the Committee's attention. In the three Chapters of this Part the Committee outlines its understanding of the characteristics of life insurance products and sets out its related conclusions and recommendations.

*In Part III*, the Committee observes upon the *cost of individual life insurance*. Chapter 7 provides a review of risk classification and related matters whereas Chapter 8 turns to the price of life insurance from the perspective of the policyholder and prospective policyholder. Parts II and III complement each other in setting out the full range of considerations in the evaluation of life insurance products.

*In Part IV*, the Committee comes to conclusions and recommendations on the topic of *disclosure* in life insurance. Chapter 9 is titled "Informing the Consumer" and sets out the Committee's views on a comprehensive system of disclosure, intended to assist the consumer in making a wise choice in the selection of a plan of life insurance suitable to his or her circumstances. The conclusions in this Part are based on the background and observations contained in the previous Parts of this Report.

*In Part V*, the Committee looks at the *marketing of life insurance*. Chapters 10, 11 and 12 cover, respectively, the topics of the agency system in the marketing of insurance; the licensing, conduct, qualifications and training of life insurance agents; and the remuneration methods used by the industry for compensating life insurance agents. The Committee's recommendations and suggestions for improvements to be pursued by the industry in the field of marketing are an integral part of these Chapters.

*In Part VI*, in Chapter 13, the Committee deals with the many other



aspects of the organization and operations of the life insurance business which ultimately affect the price policyholders must pay for the products the industry provides. These matters are covered under the broad headings of *profit emergence, profit distribution and other matters*. The Committee's observations, conclusions and recommendations concerning specific matters discussed in this Chapter, together with a number of the Committee's general observations and conclusions are made throughout this Part.

*Part VII* of this Report is a summary of the conclusions and recommendations of the Committee, as set out in Chapters 4 to 13 of this Report.



# PART I

## OVERVIEW OF LIFE INSURANCE





## CHAPTER 1

### Overview of the Public Interest in Life Insurance

#### A. INTRODUCTION

In its studies into the business of insurance, the Committee has found the insurance product to be one unlike all others. Yet, in addressing itself to the life insurance industry and the laws pertaining to it, the Committee has learned that the life insurance product is not entirely unique as it competes with a variety of alternative financial products and services. Therefore, before commenting in detail on the investigations into the business of life insurance, the Committee finds it necessary in this Chapter to examine in broad terms the need for life insurance products and the alternatives to life insurance available to consumers. The Committee concludes this Chapter with general observations on the role of the life insurance industry and the role of the government in ensuring that the consumer is well protected and served by the life insurance product.

The Committee in this Report uses the term "life insurance" to indicate the entire business of life insurance, excluding accident and sickness. That is, both life insurance products providing death benefit coverage and annuity contracts are included within the term "life insurance". Distinction between the broad business of life insurance and the more specific business of life insurance products which provide death benefits is made only where it is most necessary. As discussed more fully throughout the Report, the life insurance industry has a monopoly among financial institutions in providing life insurance products providing death benefits and although it has more competition in the business of annuity contracts, it also has a monopoly in providing annuity products when payouts are contingent on the survival of one or more lives.

#### B. THE SYSTEM OF INCOME PROTECTION

Life insurance cannot be discussed without reference to public expectations about "financial protection" or "social security". The Committee recognizes that the public of Ontario are concerned about financial protection. This concern reflects the concept that there is an obligation to provide financial support for oneself and one's family or dependants for as long as the family or dependant has need of funds, even if one is disabled or does not live to fulfil that need. This concern also reflects the realization by many individuals that those who are best looked after in time of need are those who look after themselves by investing, saving or insuring for loss of income in the future.

The spectrum of financial protection is a broad one ranging from income maintenance during sickness or recovery from accident, to income protection in the case of unemployment, to income maintenance for dependants in the case of death or disability, through to income maintenance after retirement. Included as well is the need to meet specific expenses such as medical treatment or death and burial expenses.

Life insurance products assist individuals to meet part of this broad spectrum of financial protection needs. In generalized terms, life insurance products which provide death benefits meet the income maintenance needs of dependants upon death of the insured and annuity products meet the income needs of the policyholder upon retirement.

Yet life insurance products form only part of a proliferation of alternative private means available to consumers to meet their or their dependants' financial protection needs at death or retirement. Other means of financial protection in these circumstances include savings through various financial institutions and investments of various types. Although these means of financial protection are not directly comparable to a plan of insurance related to life expectancy, the Committee cannot disregard these "protection" alternatives which compete for the same dollar potentially available for life insurance.

Accordingly, the Committee finds that the life insurance industry cannot be considered in isolation as might the automobile and other property and casualty insurance industries. In the latter two insurance sectors, protection of the public interest in terms of adequate coverage, fair marketing practices and so on is provided largely within the insurance system. Property and casualty insurers have little direct competition from other institutions for the services they provide. Even self-insurance as an alternative is a significant factor only for the larger commercial firms and only for first-party risks. In the case of third-party automobile risks, the Committee recommended compulsory insurance, thereby requiring that third-party protection be provided within the insurance system.

In contrast to the automobile and other property and casualty insurance industries, the Committee finds that its study of life insurance products and services would not be complete without reference to the wide scope of financial protection alternatives available to meet consumer needs. This wide scope of financial protection alternatives is a topic to which the Committee will return throughout this Report.

## **C. THE CHANGING ENVIRONMENT OF INCOME PROTECTION**

A comprehensive review of the financial protection system and how it



meets public needs would require focus on the *whole* package of financial protection alternatives including public, private and self-administered programs. Further, such a review would need to take into account the essential aspects of financial protection within the perspective of the changing "environment" of income needs and expectations due to greater longevity, inflation, changes in other economic conditions and changing social standards.

It is beyond the scope of this Report to analyze in any definitive way the changing environment of income needs and the role and importance that various public, private and individual programs play in the full spectrum of financial protection. Nevertheless, the Committee sets out some of the changes it has noted in the past and changes it expects for the future, as background to its views upon the total financial protection system and the role of life insurance within that system.

In looking over the past, the Committee notes that both governments and employers have become increasingly active in providing a better measure of security to the people in this Province. Although the idea of a universal plan guaranteeing a basic minimum pension was not implemented until the early 1960's, today public programs for financial protection include not only income maintenance plans after retirement, such as the Canada and Quebec Pension Plans, but also other basic income maintenance programs including a national unemployment insurance plan, provincially and federally subsidized services for retired and disabled persons, workmen's compensation programs, medical insurance, tax policies providing incentives for retirement savings and more. Complementing public programs are occupational programs, sponsored by employers, demanded by unions and generally part of the expectations of the Canadian working community. These programs provide pension benefits, life insurance coverage and other income-related benefits to dependants, retired employees and disabled workers.

At the same time as government schemes and occupational plans have become major sources of income security, individual plans for income protection have also assumed greater importance. While this experience may seem to be something of a contradiction, it is essentially the result of increasing family incomes and the channeling of these incomes into long-term savings to augment future income security. It is also the result of government tax and other policies which provide an incentive for the channeling of income into retirement savings.

As to the future, it has been noted that it is beyond the scope of this Report to study in any comprehensive manner the changing and future needs for income protection and the alternative responses that may be anticipated

from individuals, various levels of government and the business community. While the Committee has not attempted to arrive at a consensus concerning what the future holds as a prerequisite to its study, it is mindful of the need to be alert to changes in the environment for financial protection.

Foremost and most disturbing among recent changes in the environment for financial protection is the impact of inflation on the value of income benefits promised in the future and on money saved for retirement. Consumer and government concern over inflation is exacerbated by the pace of economic and social change which makes it increasingly difficult to forecast the future. The expectation, however, is that inflation will continue as long-term phenomenon. Dealing with inflation presents a difficult challenge to all participants in the financial protection system and is a matter of major concern to the Committee.

More predictable and likely more manageable by the participants in the financial protection system are the following changes in the social and business environment:

- The age profile of the Canadian population is undergoing dramatic changes. A marked increase in the older population is forecast in the coming years as the “baby boom” of the late 1940’s and the 1950’s moves through the early adulthood of today into middle and old age.
- Advances in medical treatment, improvements in health care systems and growing personal interest in healthy living are likely to continue to increase life expectancy and add to the size of the older population.
- The already apparent trends toward more working women, smaller households, and population mobility will likely continue and contribute to changes in family structure. As a result reliance on family support of single, widowed and elderly relatives may weaken further, leading to an increase in emphasis on individual planning for income security.
- Consumers are becoming increasingly more sophisticated in their purchase behaviour, less willing to buy on faith and more demanding of information on the products offered to them.
- Technological advances in computer systems and communications are providing better tools for use by institutions, industries and consumers to evaluate products in the marketplace and to comparison shop.
- The pace of economic and social change appears to have increased over the last decade. As a result consumers may be finding that the products they purchased in the past no longer meet their requirements for the future.

These ongoing and expected future changes will alter government policy priorities increasingly towards income protection schemes for older people and towards related consumer concerns. These changes are also likely to require a private industry greater initiative and participation in designing financial protection plans that are:

- responsive to consumer needs;
- reasonably accessible to all, at various levels of income;
- efficient means of income accumulation;
- comparable to alternative plans to ensure the best choice for accumulation of savings dollars;
- flexible to correspond to changes in the economic environment.

These matters must be addressed in any review of the financial protection system, whether that review encompasses all aspects of the system or concentrates on a specific segment, such as the life insurance industry.

#### **D. SAFEGUARDING THE PUBLIC INTEREST**

What role should the government have in the above areas of concern? The Committee finds it more difficult in its current studies to deal with consumer needs as many fall outside the sole parameters of the insurance system. Likewise it is more difficult to define the nature of the government presence in the life insurance industry as distinct from a broader system which includes other industries providing competitive or alternate services.

Further complicating the Committee's consideration is, first, the fact that not all people have the same needs for income protection and, second, the multi-variate choice facing the consumer. Included in this choice is life insurance versus other forms of income protection, temporary term insurance protection versus permanent life insurance protection, participating versus non-participating policies, pooled versus segregated fund policies, and products with guaranteed surrender values versus new-money or adjustable policies.

The choices facing individuals are awesome. While there is an onus of responsibility on individuals to manage their affairs prudently, it must nevertheless be recognized:

- Most citizens are unsophisticated when it comes to matters of financial planning.
- *All*, even the most sophisticated, need full disclosure of product and cost information on which to base intelligent decisions.
- The commitment of funds to one plan means that these funds are *not*



available for use in another plan and if it is later determined that the use of the funds was inappropriate to the true needs of the individual, much of the investment may be lost to the individual if he switches to another plan.

These factors are sufficient in the Committee's opinion to warrant a government interest in ensuring that the consumer is given the opportunity to make a reasoned choice in his or her selection of financial protection alternatives.

At the same time, consumer expectations in regard to financial protection alternatives might be summarized as follows:

- Products that meet needs, at various income levels and without restrictive gaps.
- Guarantee of solvency and settlement of claims or accounts when due.
- Availability to all.
- A fair price to all.
- Clear understandable information and assistance in making a purchase choice to include full and factual disclosure on coverage and return on investment, planning assistance and education.
- Good value for money paid: minimization of transaction and planning costs, that is, an "efficient" operating system.
- Products that do not lock the consumer in as changes may be necessary when circumstances alter.
- Effective competition among products, companies and industries.

Again the Committee believes that there is a government interest in seeing that the consumer expectations listed above are met whenever possible. While these observations are applicable to all income protection programs in general, they apply in some manner to each of the individual segments making up the financial security system, and so they apply to life insurance.

The Committee focuses its Report on these expectations as related to the business of life insurance. The Committee therefore turns now in this Chapter to consideration of the government interest specifically in the field of life insurance.

## **E. THE GOVERNMENT INTEREST IN LIFE INSURANCE**

Alongside the general government interest in consumer protection across the broad spectrum of financial protection, the Committee believes that a special government interest exists in regard to the consumer's purchase of life insurance. In the case of life insurance there is a need to safeguard the public interest in the purchase of an intangible product, whose reliability, benefits and costs are not fully apparent at the time of purchase.

At a minimum this need to safeguard the public interest would seem to require that the government ensure that insurers meet their future obligations by paying claims or benefits when they are due. Although life insurance and its related products are designed to protect the income earner and his immediate dependants on a first party basis, the third party implications of these plans cannot be ignored. That is, if the income provided from these plans is inadequate or not adequately protected or guaranteed, public programs must take over and in effect all citizens must contribute to the deficiency.

As in its previous studies into the insurance industry, the Committee agrees that there is a “need for a government presence to oversee the industry in its conduct and responsibilities regarding the provision of the insurance product”.<sup>1</sup> In the case of life insurance this need for a government presence is maintained by the importance of life insurance as an attendant mechanism, aimed at assisting the Ontario consumer in providing income security for him or herself and for dependants. A number of observations on the role for life insurance in financial protection follow, first in relation to individuals as purchasers of life insurance and secondly in relation to employee groups.

## **F. LIFE INSURANCE—AN ATTENDANT MECHANISM FOR FINANCIAL PROTECTION**

### **Individuals**

In studying automobile and general insurance, the Committee recognized both an individual and a social need for insurance. The Committee finds however that the need for insurance is not as readily accepted in the life insurance field as in the automobile and general insurance fields. It varies more by individuals and their financial circumstances. The need for life insurance may be less essential for certain individuals who feel that they and their dependants are adequately protected by government social security systems, by employer benefit plans or by self-administered plans such as savings or investments.

Although individual needs may vary, the Committee nevertheless perceives that several factors combine to compel consumers in Ontario, at the least, to consider the purchase of life insurance products at some point in their lifetime.

First, lack of uniformity, insufficient coverage or lack of coverage in employer-funded benefit systems require that in many circumstances the individual must do his own planning for income protection and hence may consider life insurance products and annuities as one option. Lack of employer-funded protection is evident in the matter of retirement income as

1. Select Committee on Company Law, *The Insurance Industry—Third Report on General Insurance*, Province of Ontario Legislative Assembly, 1979, page 7.

only 44.1 percent of paid workers were found to be participating in group pension plans in 1978.

Second, consumers tend to view certain of the products of the life insurance industry as desirable options because of their particular status under government rules regarding income taxation. For example, death benefits from a life insurance policy are not taxable, and tax on the investment income earned on annuities is deferred and these factors might be seen as persuasive advantages to insuring for future income protection for one's family. In addition, in the case of retirement income planning, current government personal tax rules have created a burgeoning market for RRSP savings plans and annuity options for income payout. Certain of the annuity options for payout of RRSP income can only be purchased from life insurance companies.

Third, the individual is often compelled by his or her own obligations, desires and other needs for money, to "insure" for income protection rather than save. Alternatively some individuals want a means of income management that will accumulate income and distribute it at a time of need. In such cases, life insurance appeals to consumers as a convenience and sometimes as a method of forced savings.

Fourth, the Committee perceives a trend at this time to encouraging the public to participate in individual income maintenance planning, which may include consideration of life insurance, rather than to increasing public reliance on government protection systems. The ability of private systems of financial protection to meet consumer needs is therefore increasingly being subjected to consumer and government scrutiny.

## **Employee Groups**

Life insurance products and services also assist employers in developing an employee benefit program to provide for the future income needs of their employees. Group life, disability and pension plans are demanded by most employees and provided by a broad cross-section of employers. For many employers, and in particular for smaller employers, the alternative of self-insuring or self-administering group benefit plans is not a practical or financially viable approach. The life insurance industry provides the products and services which facilitate employer participation in benefit plans.

Furthermore, employee participation in group life, disability and pension plans often bestows a quasi-compulsory aspect to at least a minimum level of life insurance. Employees covered by group plans are rarely if ever provided with the opportunity to refuse participation and at the same time obtain equivalent monetary compensation which might be used for funding a private benefit plan. Participation is compelled by the simple fact of the loss of a fringe benefit received by all others in the employee group.

## **G. THE FORM OF GOVERNMENT PRESENCE IN THE BUSINESS OF LIFE INSURANCE**

The important role that life insurance plays in the broad system of financial protection is reflected in life insurance regulation. At present the life insurance industry is, in certain respects, among the most heavily regulated in Canada. There is as well a great deal of uniformity across Canada in the legislation, regulations and guidelines governing life insurance. The long historical record of industry-specific regulation of life insurance has, however, led to the result that life and annuity products for the most part are excluded from general consumer protection laws.

Whether the government presence should be based on industry-specific laws such as The Insurance Act or general consumer protection laws, such as The Business Practices Act or The Employment Standards Act in the case of employee groups, has become a matter of some debate for the Committee. The Committee's chief concern is that The Insurance Act lacks specific provisions now commonly found in general consumer legislation. The Committee recognizes at the same time the broad powers of the Superintendent in supervising the insurance industry and the formalization of guidelines by the Association of Provincial Superintendents with which insurance companies and their agents voluntarily comply.

It has been brought to the Committee's attention, however, that consumers and their lawyers are often unaware of the guidelines, in-house rules or general powers of the Superintendent. Moreover, consumers do not in most cases have specific legal remedies against the insurance industry which would permit an action in court; rather they must address their complaints to the Superintendent upon whom the authority to discipline the industry falls. In contrast, in the sale of most other goods and services, the consumer has direct legal redress under the provisions of various consumer laws.

Despite the flexibility of supervision afforded by The Insurance Act, the question of the broad and in most cases retrospective powers of the Superintendent has arisen before the Committee in earlier studies of the insurance industry, wherein the Committee commented:

“The Committee is also concerned that the present Act puts the Superintendent in the position of being, in a sense, legislator, prosecutor and judge in certain circumstances.”

This concern is equally important in the study of the life insurance industry.

Of some concern also is the difference in form of regulation among various industries in the financial protection system. At the same time, it seems unacceptable to the Committee that similar standards of consumer protection do not apply to all product areas, companies and institutions within the fi-



nancial protection system. This concept leads the Committee to conclude that The Insurance Act should be reviewed periodically to incorporate the provisions of general consumer legislation and at the same time that general statutes providing consumer protection should be so amended to include life insurance and annuities as well as competing financial investment and savings instruments.

The Committee will address these issues further throughout this Report, in commenting more specifically on the operations of the life insurance industry.

## **H. OBSERVATIONS ON THE FORM OF GOVERNMENT PRESENCE**

The thrust of the Committee's recommendations in this Report reflects three key guidelines followed by the Committee in its previous Reports.

- a) The government presence in the insurance industry should devote explicit attention to the consumer's needs.
- b) The government presence should not unduly burden the private insurance industry by over-regulation.
- c) The private insurance industry must demonstrate its commitment to providing protection against risks at a reasonable price to all citizens of the Province of Ontario.

Accordingly, the Committee makes two series of recommendations. The first series consists of proposals to guide the insurance industry in improving the insurance system. The second consists of a number of recommendations that call for direct government involvement in making certain explicit and fundamental changes in the insurance system.

The first series of recommendations recognizes that there is an onus on insurers to market with consumer satisfaction in mind, just as there is an onus on consumers to shop wisely. As in its previous Reports, the Committee attempts in this Report to point out, from its investigations, areas requiring increased insurer attention toward improved consumer satisfaction. At the same time the Committee believes that the life insurance industry is a mature industry and is capable of striving to meet consumer needs. The alternatives, should the industry fail in its obligations to the consumer, are seen by the Committee to be:

- the government fostering improvements in the industry-operated insurance system;
- the government regulating the actions of the industry in varying degrees short of discouraging its existence; or
- the government meeting the need for protection through a publicly administered insurance mechanism.

The second series of recommendations recognizes that an overlap exists between social or government responsibility in the event of a loss and individual responsibility in pre-planning for the consequences of injury or loss. A voluntary market for insurance does not necessarily ensure that acceptable levels of protection are available to all, principally to third parties. In previous Reports on insurance, the Committee concluded that the government should step in to impose explicit requirements on the insurance system, for example through compulsory automobile insurance. Likewise in the life insurance sector, the Committee concludes that explicit measures are needed to improve the consumer's ability to purchase products appropriate to his and his dependants' protection needs.

Clearly in recommending the imposition of explicit requirements on the life insurance system the Committee is in conflict with the concept of minimum regulation. Nevertheless, it is the Committee's conclusion that, in certain cases, the government's emphasis must fall most emphatically on consumer or public needs. It is this conclusion which leads the Committee to recommend in this Report a mandatory system of disclosure in the sale of life insurance and to set out further recommendations for changes in The Insurance Act and the regulations thereunder, and for changes in the authority and responsibility of the Superintendent of Insurance in this Province.

In regard to the authority and responsibility of the Superintendent of Insurance, the Committee concludes that the historic emphasis of the Superintendent on solvency must now be balanced by attention to other aspects of consumer protection. The Committee believes that the thrust to consumer protection in the field of life insurance should be undertaken directly and *visibly* by the Superintendent of Insurance in this Province and should not be left to fall on the initiative of so-called "consumer advocates" whose interests are in the interest of the consumer but who do not have the expertise or resources to challenge the life insurance industry.



## CHAPTER 2

### The Life Insurance Market

#### A. INTRODUCTION

Against the background of the need for life insurance as one response among an array of alternative responses to meet the financial protection needs of consumers, this Chapter provides an introductory review of the products provided by the life insurance industry together with a summary of certain data concerning the present structure and operations of the industry.

As discussed in some detail throughout this Report, the supervisory responsibility for various aspects of the life insurance business in Ontario and Canada is by agreement and historic precedence divided among the federal and various provincial authorities. While considerable information is gathered by each of these jurisdictions regarding their particular area of concern, one consequence of these arrangements is that neither the federal nor provincial authorities prepare a complete summary of information that covers the operations of the entire insurance industry either in Canada as a whole or in any one Province. In addition, there is no industry-sponsored centre of information that purports to provide data concerning the combined operations of all life insurers in Canada or in the Province of Ontario.

The most comprehensive data that are available are prepared by the Canadian Life Insurance Association (CLIA). The CLIA summarizes information concerning the life insurance industry from a variety of sources, principally reports prepared by the Federal and Provincial Superintendents of Insurance. The data accumulated by CLIA are published in an annual booklet, "Canadian Life Insurance Facts".

The data in this booklet suffer from certain deficiencies. First, they do not present the complete summary of the life insurance industry in Canada in that statistics concerning the life insurance operations of fraternal and mutual benefit societies are not included. Second, since the booklet is an industry publication, it is natural that the information selected and the method of presenting these data are designed to show the industry in a favourable light. For these reasons the Committee would have preferred to have relied on a more objective compilation of information to obtain a general perspective of the size, growth, markets and customers, etc. of the industry.

However, for its purposes the Committee found that data in Canadian Life Insurance Facts suitable as providing an overview of certain aspects of the industry's activities, particularly since the Committee was able to confirm, by reference to the reports prepared by the Federal Superintendent of Insurance and other sources, the general accuracy of the more significant items it contains. Since the Committee and its staff did not undertake any detailed review and analysis of their own, most of the references to the



amounts of premiums, insurance in force, numbers of policies, etc. in this Chapter, and throughout the Report, have been provided by the CLIA.

**B. THE ROLE OF THE LIFE INSURANCE INDUSTRY IN THE FINANCIAL PROTECTION SYSTEM**

The role the life insurance industry plays in the financial protection system throughout Canada is a very significant one.

In 1978, individuals and groups in Canada paid \$5.0 billion in premiums for life insurance and received \$2.9 billion in benefits. These amounts represent an increase over the prior year of 12% and 16% respectively. Premiums paid in 1978 represented 3.27% of the disposable income of all Canadians. Historically Canadians have paid between 3.25% and 3.75% of their disposable income to life insurance companies for financial protection.

One common measure of the size of an individual insurer and of the magnitude of the industry as a whole is the dollar amount of life insurance in force. This measure is appropriate for life insurance which provides death benefits and is the sum of the face amounts of these policies outstanding at a point in time. The measure is not appropriate for annuity contracts for which the number of contracts outstanding is a better measure of size and market penetration.

Table 1 presents a summary of individual and group life insurance which provides death benefits in force in Canada for several recent years.

**TABLE 1**  
**LIFE INSURANCE WHICH PROVIDES DEATH**  
**BENEFITS IN FORCE IN CANADA<sup>1</sup>**  
(\$ millions)

	<b>Individual</b>	<b>Group</b>	<b>Total</b>
1960	\$ 32,128	\$ 14,739	\$ 46,867
1970	62,845	55,977	118,822
1974	87,673	100,998	188,671
1975	98,224	121,688	219,912
1976	111,140	146,012	257,152
1977	124,399	169,321	293,720
1978	140,377	192,359	332,736

1. Data excludes fraternal and mutual benefit societies which account for about 1 percent of the life insurance in Canada.

Source: Canadian Life Insurance Facts, 1979 Edition.

Table 2 sets out a partial summary of the number of annuities issued by insurance companies.

TABLE 2  
NUMBER OF ANNUITIES OWNED  
BY TYPE - CANADA<sup>1</sup>  
(000's)

	Individual Annuities	Group Certificates	Settlement and Disability Annuities	Total
1960	120	410	31	561
1970	153	602	35	790
1974	381	488	42	911
1975	423	496	45	964
1976	479	504	50	1,033
1977	517	510	55	1,082
1978	563	544	59	1,166

1. Figures are for federally registered companies only and do not include provincially incorporated companies or fraternal and mutual benefit societies which together account for about 7 percent of life insurance in Canada.

Source: Canadian Life Insurance Facts, 1979 Edition.

A recent trend has been toward more individual annuities mainly for registered retirement savings and income averaging plans. Since 1974, the number of individual contracts has increased by 48% while the number of group certificates has increased by 11%.

In order to meet future policy obligations, the industry maintains policy reserves secured by investment portfolios. At the end of 1978, these investments, including cash, were valued at \$33.9 billion. Of this total, \$29.4 billion were invested in bonds, stocks and mortgages. The dollar amount of the assets of the life insurance companies compares with the assets of other major saving-type institutions as at the end of 1978 as follows:<sup>1</sup>

	\$ Millions
Chartered Banks—Personal Savings	\$ 51,528
Life Insurance Companies	33,926
Trusteed Pensions (estimated)	33,000
Trust Companies	27,906
Credit Unions	23,976
Canada Savings Bonds	20,183
Canada Pension and Quebec Pension Plans	18,293
Mortgage Loan Companies	10,285
Mutual and Closed-end Funds	4,775
Quebec Savings Bonds	1,452
Government Annuities	1,222
	<u>\$226,546</u>

1. Canadian Life Insurance Association.

Life insurance companies account for 15.0% of the total assets of the institutions listed—this portion has declined from 20.8% in 1970, 15.6% in 1976 and 15.2% in 1977—mainly as the result of the growing importance of chartered banks and trustee pensions.

Since most life insurers operating in Canada carry on their business throughout the whole country, very little industry-wide information is summarized that relates only to their operations in Ontario. Those data that are developed indicate that the residents of Ontario purchase life insurance to a greater extent than other Canadians. Approximately 36% of the population of Canada are residents of Ontario, however, Ontarians accounted for:

- about 39.7% of life insurance premiums for policies which provide death benefits in both 1977 and 1978
- 40% of the life insurance in force at December 31, 1978
- 39.2% of the new face amount of life insurance providing death benefits effected in 1978, and
- approximately 48.3% of all annuity premiums in both 1977 and 1978 including about 38% of all individual annuity premiums and almost 57% of all group annuity premiums.

As a further indication of the importance of the life insurance industry to the economy of Canada and Ontario in particular, in 1978, there were 169 active and 8 inactive companies carrying on operations in Canada, 127 of which were licensed to sell in Ontario. The life insurance companies across Canada employed 50,400 people including head office, agency and administrative personnel; of this total, 25,650 were employed in the Province of Ontario.

More detailed comments concerning some aspects of the past history and current status of the industry are set out in the following sections of this Chapter under the general headings "Products" and "The Industry".

## C. PRODUCTS

Life insurance is an agreement made by an insurer to pay a sum of money to another party upon the happening of an event to a human life. Life insurance<sup>1</sup> consists of two major product groups, life insurance which provides death benefits and life annuities.

Life insurance which provides death benefits is a contract wherein the insurer agrees to pay a sum of money to another party on the *event of the death of a person*. On the other hand, a life annuity is a contract wherein the

1. As noted in Chapter 1, throughout this Report the Committee uses the term "life insurance" to indicate the entire business of life insurance, excluding accident and sickness. That is, both life insurance products providing death benefit coverage and annuity contracts are included within the term "life insurance". Distinction between the broad business of life insurance and the more specific business of life insurance products which provide death benefits is made only when it is most necessary.

insurer agrees to pay a sum of money in the form of *specified amounts over consecutive periods* in the *event of the survival of a person* past a specified age. The two life insurance products are related in that they both involve agreements to pay a sum of money, on the happening of an event to a human life.

Life insurance is sold either as an individual contract or as a group contract. An individual policy is a contract between an insurer and a specified individual. It is a policy designed to address the particular life insurance needs of that individual. A group policy is a contract in which a group of people are insured under a single master contract. The contract is with a group policyholder and the individual lives insured are not direct parties to the contract.

In sum, there are four distinct segments of the life insurance business:

- individual life insurance
- individual annuities
- group life insurance
- group annuities.

Within these segments is a wide range of product types sold by the life insurance industry. Included as well in these segments is a range of related services provided by life insurance companies. A brief review of the array of products and services available from the life insurance industry follows.

## **1. Individual Life Insurance**

As at December 31, 1978 there was approximately \$140 billion of individual life insurance in force in Canada. Canadians paid \$1,972 million in premiums in 1978 for individual life insurance to account for about 39% of all life insurance business that year. There are three general forms of life insurance available to an individual—whole life, endowment and term. The distinguishing features among them relate principally to the expiry date of the contract.

### *Whole Life Insurance*

A whole life policy provides for the sum insured to be paid when the life insured dies. The protection is in effect for the life insured's lifetime and since there is no time limit on the policy, it is sometimes referred to as "permanent", "ordinary life" or "straight life" insurance.

Traditionally, whole life policies have represented the largest single type of life insurance protection sold. In recent years, however, while the whole life business continues to grow it does so more slowly than term insurance.



**TABLE 3**  
**INDIVIDUAL LIFE INSURANCE—CANADA**  
**PERCENT OF NEW FACE AMOUNT BY TYPE OF INSURANCE**

Type	1960	1970	1974	1975	1976	1977	1978
Permanent <sup>1</sup>	58%	45%	43%	41%	39%	38%	35%
Term	42	55	57	59	61	62	65
	100%	100%	100%	100%	100%	100%	100%

1. Whole life and endowment.

Source: Canadian Life Insurance Association.

Of the total of individual life insurance sales in 1978, 35% were permanent insurance, that is, whole life and endowment, and 65% were term insurance. Table 3 summarizes the proportion of sales of each class of insurance for several years since 1960 indicating clearly the trend to term throughout the period.

**TABLE 4**  
**INDIVIDUAL LIFE INSURANCE—CANADA**  
**PERCENT OF INSURANCE IN FORCE BY TYPE OF INSURANCE**

Type	1960	1970	1974	1975	1976	1977	1978
Permanent <sup>1</sup>	73%	62%	58%	56%	53%	53%	50%
Term	27	38	42	44	47	47	50
	100%	100%	100%	100%	100%	100%	100%

1. Whole life and endowment.

Source: Canadian Life Insurance Association.

Despite the trend in sales to term insurance in the past 20 years, permanent insurance continues to represent one-half of the individual life insurance in force in Canada in 1978. The steady decrease in the share of the total accounted for by permanent insurance is apparent once again from the data in Table 4. In 1960, 73% of all individual life insurance in force was of the permanent type, by 1970 the proportion was down to 62% and in 1978 to 50%.

**TABLE 5**  
**WHOLE LIFE INSURANCE<sup>1</sup>—CANADA**

	1970	1975	1977	1978
Percent of New Policies	54%	55%	54%	55%
Percent of New Face Amount	35%	33%	32%	31%
New Face Amount (\$ billion)	\$3.2	\$6.0	\$7.6	\$8.2
Increase over Previous				
Year in New Face Amount		22.4%	10.1%	7.7%

1. Includes whole life and limited pay life, but does not include any portion of family or combination policies.

Source: Based on data included in Canadian Life Insurance Facts.

Table 5 presents a summary of data concerning new whole life insurance sales in several recent years. The growth of whole life is apparent from the increase shown in the new face amount of insurance sold which rose from \$3.2 billion in 1970 to \$8.2 billion in 1978. However, these amounts expressed as a percent of the total new business reflect a steady decrease in each year from 35% of the total in 1970 to 31% in 1978.

The basic concept of whole life insurance in providing a sum of money when a life insured dies is relatively simple. However, over time, the life insurance companies responding to perceived consumer needs have developed modifications to the basic plan. Today, an individual wishing to purchase a whole life policy is faced with a multitude of options and modifications to the basic policy. Options, riders and other considerations include *at least*:

- 7 options concerning the period over which premiums may be paid
- 6 options regarding the frequency of payment of premiums
- 16 options relating to the settlement of the sum insured
- the choice of a reduced sum insured at a specific age
- 3 options concerning the designation of beneficiaries
- the choice of a joint policy
- 4 non-forfeiture options
- variations in the rates of interest on a policy loan
- a choice between a participating and a non-participating policy
- 8 dividend options on participating policies
- 4 reinstatement options
- a waiver of premium option
- a cost of living rider
- a “double indemnity” rider
- a disability income rider
- an option, in some cases, to purchase a guaranteed policy rider
- the availability of preliminary term insurance.

A recent innovation has been the introduction of “adjustable benefit” or “new money” policies. They differ from the typical whole life policies in that they do not guarantee the face amount of the policy, hence the term “adjustable benefit”.

A further complication in the purchase decision results because many of the policies are not referred to as whole life insurance but by names related to some feature in the plan such as:

- Ordinary Life
- Straight Life
- Select Life
- Extraordinary Life
- Preferred Risk Policy
- Single Premium Policy
- 20 Pay Life

- Life 20
- Life Paid-up at 60 or Life 60
- Life Paid-up at 65 or Life 65
- Increasing Sums Insured
- Juvenile Life Insurance
- Life Modified at 70
- Adjustable Single Premium Whole Life
- Junior Adjustable Policy
- Decreasing Whole Life
- Joint Whole Life
- Joint Decreasing Whole Life

In addition to these “general” names, certain life companies add to the complexity by substituting “brand” names for particular policies.

### *Endowment Life Insurance*

Endowment insurance is a variation of individual life insurance. The sum insured is payable on the death of the life insured; alternatively if the life insured is living on a specified date the sum insured will also be paid. The policy does not expire without benefit. In this respect, endowment, like whole life is “permanent” insurance.

Endowment insurance represents a small proportion of individual life insurance. In 1978, 8% of the new policies accounting for 4% of the insurance placed in force that year were of the endowment type.

TABLE 6  
ENDOWMENT LIFE INSURANCE<sup>1</sup>—CANADA

	1970	1975	1977	1978
Percent of New Policies	13%	12%	10%	8%
Percent of New Face Amount	8%	8%	6%	4%
New Face Amount (\$ billion)	\$0.7	\$1.5	\$1.3	\$1.1
Increase over Previous				
Year in New Face Amount		-16%	ϕ	-18%

1. Includes endowment and retirement income policies, but does not include any portion of family or combination policies.

Source: Based on data included in Canadian Life Insurance Facts.

Table 6 presents a summary of new endowment insurance sales in several years since 1970. The new face amount of endowment sales in 1978 was \$1.1 billion down from \$1.5 billion in 1975. The relative importance of endowment insurance is apparent when the \$1.1 billion of new business for endowment in 1978 is compared with sales of whole life of \$8.2 billion, term of \$11.6 billion and combination policies of \$5.5 in that year.

Many of the policy options, riders and other considerations noted re-

garding whole life are available with endowment insurance. Also, as in case of whole life, endowment policies are referred to by a number of general names and individual companies often use their own brand names for particular endowment policies to appeal to various segments of the market.

### *Term Insurance*

Term insurance is another modification of individual life insurance as protection is provided for a specified term or period of time only. The insurer will pay the sum insured to the beneficiary only if the death of the life insured occurs within the specified period. If the life insured is alive at the end of the period, the policy expires and the protection ends with no "living benefit".

Premiums for term insurance are the lowest offered by a company for individual life insurance, since the calculation of the premiums is based not on the certainty of death but only on the possibility of death during the term of the policy. Term insurance may be renewable in that a new term policy may be taken out when the previous one expires. Since the life insured will be older at each renewal, the premium for the same amount of insurance will be higher at each such anniversary.

At present, term insurance is the fastest growing form of individual life insurance protection. Term life insurance in force in 1978 was just over \$70 billion and represented one half of the life insurance in force in Canada. Table 7 presents a summary of data concerning new term insurance sales in Canada for 1970, 1975, 1977 and 1978.

TABLE 7  
TERM LIFE INSURANCE<sup>1</sup>—CANADA

	1970	1975	1977	1978
Percent of New Policies	13%	17%	20%	21%
Percent of New Face Amount	29%	38%	42%	44%
New Face Amount (\$ billion)	\$2.6	\$6.9	\$10.0	\$11.6
Increase over Previous				
Year in New Face Amount		30.2%	19.0%	16.0%

1. Includes level and decreasing term only, but does not include any portion of family or combination policies.

Source: Based on data included in Canadian Life Insurance Facts.

Term insurance has developed in the same manner as whole life, from a basic policy concept to include an array of options and modifications. Many of the options which apply to whole life also are applicable to term insurance such as:

- the frequency of payment of premiums
- the designation of beneficiaries



- the participating/non-participating policy choice
- the dividend options on participating policies.

In addition there are some options which are applicable only to term insurance including:

- the term insured with a wide range of alternatives
- various conversion options
- variable coverage options
- renewal options.

Term insurance has not developed the same proliferation of brand names as whole life insurance. However, there are many names for variations of the basic term policy designed to refer to specific features of the alternatives. One popular name for a form of term coverage is mortgage insurance sold on the basis of providing term life insurance to cover the outstanding mortgage on a property.

### *Combination Life Insurance*

In addition to the many options and modifications in the form of riders that life insurance companies provide to adapt basic whole life, endowment and term policies to meet the perceived needs of individuals, companies have devised a perplexity of packages or “combinations” of these policies.

Combination policies are conceived to present a variety of alternatives to the individual or family so that all or substantially all life insurance needs will be covered in one policy. Further refinements are also provided so that as an individual’s circumstances change, additions or modifications to the policy may be made by means of riders. A typical combination policy would be a whole life policy combined with a decreasing term policy purchased in the form of a mortgage protection rider. The same coverage could be purchased in its basic components.

The names applied to combination policies are as varied as the permutations and combinations of whole life, endowment and term policies with the various options and riders will permit. Any attempt to prepare a comprehensive list of names applied to combination policies would be unproductive.

Combination policies represent a significant portion of the individual life insurance sold in Canada. Table 8 presents a summary of the family and combination policies written for several years since 1970.

In 1978, \$5.5 billion of new individual life insurance was purchased by way of combination policies. This amount is up from \$4.7 billion in 1977, an increase of 17% in the year. As a percent of the new face amount of individual life insurance sold, it represented 21% of the total in 1978, compared with 44% for term, 31% for whole life and 4% for endowment policies.

**TABLE 8**  
**COMBINATION LIFE INSURANCE POLICIES—CANADA**

	1970	1975	1977	1978
Percent of New Policies	20%	16%	16%	16%
Percent of New Face Amount	28%	21%	20%	21%
New Face Amount (\$ billion)	\$2.5	\$3.8	\$4.7	\$5.5
Increase over Previous				
Year in New Face Amount		18.8%	-4.1%	17.0%

*Source:* Based on data included in Canadian Life Insurance Facts.

## 2. Group Life Insurance

Canadian groups paid \$801 million in premiums in 1978 for group life insurance, 16% of all life insurance premiums that year.

The terms of a group life insurance policy generally require the insured, the group policyholder—a company, club or society—to remit a premium to the insurer and in return the insurer to pay a sum of money to a beneficiary on the death of a life insured, a member of the group. In some instances, individual members remit premiums directly to the insurer rather than through the group policyholder. In cases where the policyholder pays the premium, the administrative costs for the insurer are reduced and it is possible to offer a lower premium.

The sum insured or benefits of group insurance are not tailored to the insurance needs of the individual. Benefits are established for the group as a whole, and may be the same for everyone or may be geared to such factors as length of employment, age, remuneration or position in the organization.

Most group plans are term insurance. When a member of the group leaves the organization, protection ceases without any interest vesting in the member, although most policies provide some form of conversion privileges. Permanent group insurance plans are available but are more expensive and few are sold.

The importance and growth of group life insurance in recent years is illustrated in the following table which compares individual and group life insurance in force in 1960 and in several intervening years to 1978. Of the total of life insurance providing death benefits in force in 1978 57.8% is group insurance compared with 31.4% in 1960 and 47.1% in 1970. Group life insurance in force in 1960 was under \$15 billion; in 1978 it was over \$192 billion.

Group life insurance is becoming a very common benefit offered by employers. It not only provides the employee with low cost income protection in the case of death, but also assists a company to meet its responsibilities to the surviving family of an employee who dies.

TABLE 9  
LIFE INSURANCE IN FORCE—CANADA  
BY TYPE OF INSURANCE<sup>1</sup>  
(\$ billions)

Year	Group		Individual		Total In Force
	Amount	Percent of Total	Amount	Percent of Total	
1960	\$ 14.8	31.4%	\$ 32.1	68.6%	\$ 46.9
1970	56.0	47.1	62.8	52.9	111.8
1974	101.0	53.5	87.7	46.5	188.7
1975	121.9	55.3	98.2	44.7	219.9
1976	146.0	56.8	111.2	43.2	257.2
1977	169.3	57.6	124.4	42.4	293.7
1978	192.3	57.8	140.4	42.2	332.7

1. Excludes fraternal and mutual benefit societies.

Source: Canadian Life Insurance Association.

### *Creditor's Life Insurance*

The growth of consumer credit has given rise to another form of group life insurance—creditor's life insurance. In this case, a policy is written between an insurer and a lending institution and is intended to protect both the borrower and the lender in the event of the death of the borrower before a loan is repaid. In most cases, the cost of such insurance is charged to the borrower as part of the cost of the loan.

Of the total group life insurance in force in 1978, 81% or approximately \$155 billion was coverage for groups of employees and members of associations and unions. The balance amounting to about \$37 billion was creditor's life insurance.

### **3. Life Annuities**

Essentially the terms of a life annuity require the insured to pay a premium to the insurer and in return the insurer to make a series of equal payments at regular annual or more frequent intervals for as long as the life insured lives. Because life annuity payments are guaranteed until death, life expectancy is an integral part of the premium and benefit calculation. It is for this reason that life annuities are sold only by life insurance companies. In response to concerns that the annuitant might not live long enough to have the premium returned, insurance companies have developed various options which may guarantee annuity payments for a minimum number of years regardless of death or which may guarantee the return of the original premium either by way of annuity payments or in some other manner. Joint survivorship annuities are also available and guarantee annuity payments for the lifetime of the last survivor.

## *Funding a Life Annuity*

Based on the concept of the transfer of a sum of money, a premium, to the insurer to purchase a life annuity, there are four basic ways this premium may be funded:

- by way of a single lump sum amount paid to the insurer which is then used immediately as the premium for the life annuity with payments by the insurer to commence with the next payment anniversary date. In this case the annuitant purchases an *immediate* annuity and this is the term used in the industry.
- by way of three other alternatives each of which involve the payment of a sum(s) of money to the insurer at a time(s) prior to the date at which the accumulated sum is to be used as the premium for the life annuity. The three alternatives within this concept are:
  - a single lump sum payment,
  - a series of regular payments, or
  - a series of irregular payments.

Since the commencement of the life annuity is *deferred* during the accumulation period, annuity contracts of the latter three types are called deferred life annuities.

In essence, a deferred life annuity can be viewed as being made up of two parts:

- the accumulation at interest, of the premium over the period of deferral, and
- the purchase of an immediate annuity with the accumulated funds at the end of the deferral period.

Both individual and group annuities are sold and the four funding alternatives are all available under individual and group contracts. An individual annuity policy is a contract between an insurer and a specified individual and is designed to meet the particular needs of that individual. A group annuity policy is a contract that covers a group of people under a single master contract. The contract is with a group policyholder and the individual annuitants are not direct parties to the contract.

## *Annuities Certain*

In addition to life annuities which guarantee payments until death, there are also annuities certain which provide benefits for a fixed number of payments. Life insurance companies offer annuities certain, but since there is no life expectancy factor in the calculation of premiums and benefits, other financial institutions also offer this product.



## *Alternatives in Annuity Contracts*

The proliferation of alternative products that an annuity buyer faces is almost as awesome as that encountered by the purchaser of life insurance providing death benefits. There is first the basic choice of a life annuity or an annuity certain. As discussed then the purchaser may make the choice of four methods of funding and at least five settlement options. Further the applicant has choices concerning the designation of beneficiaries under certain circumstances, a waiver of premium option, the choice of whether to purchase a participating or non-participating annuity and in many cases the option of registering the plan as a registered retirement plan.

## *Market for Annuities*

The following table summarizes for several years in the period 1960 to 1978 the premium income from annuities received by life insurance companies registered federally and provincially in Canada, excluding fraternal and mutual benefit societies who are not significant participants in the business.

TABLE 10  
ANNUITY PREMIUM INCOME  
CANADIAN LIFE INSURANCE COMPANIES<sup>1</sup>  
(\$ million)

Year	Individual Premiums		Group Premiums		Total Premiums
	Amount	Percent of Total	Amount	Percent of Total	
1960	\$ 33	17.9%	\$ 151	32.1%	\$ 184
1965	64	19.6	262	80.4	326
1970	126	28.8	311	71.2	437
1974	542	46.7	618	53.3	1,160
1975	634	46.3	735	53.7	1,369
1976	772	46.6	884	53.4	1,656
1977	880	45.9	1,039	54.1	1,919
1978	1,066	47.3	1,188	52.7	2,254

1. Excludes fraternal and mutual benefit societies.

Source: Canadian Life Insurance Facts, 1979 Edition.

From a total of \$184 million in 1960 the annuity premium income of life insurance companies grew better than twelve fold to \$2.25 billion in 1978. As a proportion of the total premium income of insurance companies in 1978, annuities represent more than 45% while in 1960 and 1970 the proportion was about 19% and 23% respectively.

The growth in annuity premiums for each segment, individual and group, is also set out in Table 10. Premiums paid for group annuities in-

creased from \$151 million in 1960 to almost \$1.2 billion in 1978 or by almost eight times. The growth in the popularity of individual annuities has been even more spectacular—in 1960 only \$33 million in premiums were paid for individual annuities, and even in 1970 the amount was still a relatively modest \$126 million when compared with the more than \$1,065 million Canadian paid in premiums in 1978.

As a percentage of annuity premium income of life insurance companies, premiums for individual annuities now represent very close to one-half of the total whereas in 1960 and 1970 respectively they represented 18% and 29%. The growth in popularity of individual annuities is mainly in response to the favourable income tax provisions regarding annuities in connection with registered retirement savings and income averaging plans.

## **D. THE INDUSTRY**

This section deals with the structure and operations of the life insurance industry under a number of headings:

1. Ownership of the Life Insurance Companies
2. Corporate Concentration
3. Stock and Mutual Companies
4. Participating and Non-Participating Policies
5. International Operations
6. Diversification of Life Insurance Companies
7. Trade Associations
8. Assets of Life Insurance Companies
9. Policy Reserves
10. Other Liabilities of Life Insurance Companies
11. Equity of Life Insurance Companies
12. Premium Income
13. Benefit Payments
14. Sources and Uses of Income.

### **1. Ownership of the Life Insurance Companies**

Table 11 presents an analysis of the number of active life insurance companies in Canada in 1978, differentiating Canadian from foreign owned and non-resident companies and stratifying each by premium level in that year.

It is not uncommon in an industry for there to be a few large and many small companies. As Table 11 indicates this is true of the life insurance industry in Canada. Of the active companies in 1978, 15 or less than 9% of the total of 169 generated premiums in excess of \$100 million that year. On the other hand, 113 companies or 67% of the total, each received premiums of less than \$10 million.

TABLE 11  
NATIONALITY OF LIFE INSURANCE COMPANIES  
BY SIZE, BASED ON 1978 PREMIUMS  
(\$ millions)

Nationality	Over \$100	\$10-\$100	Under \$10	Total	Percent
Canadian Owned	10	21	27	58	34%
Canadian Incorporated, Foreign Owned	1	11	13	25	15
Non-Resident	4	9	73	86	51
	<u>15</u>	<u>41</u>	<u>113</u>	<u>169</u>	<u>100%</u>

Source: Canadian Life Insurance Association.

Canadian owned life insurance companies play a dominant role in the Canadian market. Canadian owned companies are defined as companies incorporated in Canada with the majority of control in the hands of residents of Canada. The majority of control of foreign owned companies rests with non-residents of Canada. While companies incorporated in Canada may be foreign owned, the Canadian and British Insurance Companies Act requires the majority of directors be Canadian citizens resident in Canada. Non-resident companies are branch operations of foreign insurance companies licensed to transact life insurance business in Canada but are not incorporated in Canada.

As Table 11 indicates, Canadians own only 34% of the active life insurance companies in Canada. However, of the large and medium sized companies, Canadians own 10 of the 15 companies that accounted for over \$100 million in premiums in 1978 and 21 of the 41 companies generating between \$10 and \$100 million in premiums that year. There were 73 smaller non-resident operations carrying on business in Canada with premium volume of under \$10 million in 1978. They represent 43% of all active companies but account for a relatively small proportion of total premiums.

Table 12 on the facing page summarizes particulars concerning the 15 life insurance companies with premium income in Canada in 1978 in excess of \$100 million. Also shown are the premium income of Canadian companies outside Canada in that year. Five of the companies are stock companies and 10 are mutuals and as previously noted 10 are Canadian owned and five foreign owned, three American and two British.

The total figures of the business of the Canadian owned companies presents a better perspective of the dominant role of Canadian owned companies in the life insurance business in Canada. Table 13 compares premium income, assets and life insurance in force for Canadian owned, foreign owned and non-resident life insurers carrying on business in Canada in 1978.

TABLE 12

## INSURANCE COMPANIES IN CANADA

WITH 1978 CANADIAN PREMIUMS OVER \$100 MILLION  
RANKED IN ORDER OF TOTAL CANADIANS PREMIUMS  
(\$ Million)

Company	Nationality	Ownership	In Canada		Outside Canada	
			Life	Annuity	Life	Annuity
			Total		Total	
Sun Life Assurance Company of Canada	Canadian	Mutual	\$231	\$202	\$433	\$226
London Life Insurance Company	Canadian	Stock	294	76	370	-
Mutual Life Assurance Company of Canada	Canadian	Mutual	177	161	338	-
Great West Life Assurance Company	Canadian	Stock	143	183	326	246
Manufacturers Life Insurance Company	Canadian	Mutual	75	214	289	97
Canada Life Assurance Company	Canadian	Mutual	122	161	283	16
Metropolitan Life Insurance Company	American	Mutual	213	28	241	N/A
Standard Life Assurance Company	British	Mutual	41	196	237	N/A
Confederation Life Insurance Company	Canadian	Mutual	88	140	228	103
Prudential Insurance Company of America	American	Mutual	159	41	200	N/A
North American Life Assurance Company	Canadian	Mutual	58	101	159	47
Crown Life Insurance Company	Canadian <sup>1</sup>	Stock	94	40	134	142
Excelsior Life Insurance Company	American	Stock	50	77	127	-
Prudential Assurance Company Limited	British	Stock	79	40	119	N/A
Desjardins Mutual Life Assurance Company	Canadian	Mutual	88	30	118	-
15 Largest Life Insurance Companies in Canada			\$1,912	\$1,690	\$3,602	

## Note:

Metropolitan Life, Standard Life, Prudential Insurance and Prudential Assurance operate in Canada as branches of foreign life insurance companies. The premiums outside Canada, therefore, are not available and are marked "N/A". Where any amount is less than one million dollars, a dash (-) is used as an indicator.

- <sup>1</sup> Excelsior Life Insurance Company is incorporated in Canada, but majority of share ownership is held by persons ordinarily resident in the United States.



**TABLE 13**  
**LIFE INSURANCE IN CANADA, 1978**  
**BY NATIONALITY OF COMPANY<sup>1</sup>**  
(\$ millions)

Nationality	Number of Companies	Premium Income	Assets Held in Canada	Life Insurance in Force	
				New—1978	Total
Canadian Owned	59	\$3,437	\$23,581	\$28,427	\$224,859
Canadian Incorporated, Foreign Owned	25	524	2,830	7,190	34,245
Non-Resident	93	1,066	7,515	12,696	73,632
Total	177 <sup>2</sup>	\$5,027	\$33,926	\$48,313	\$332,736

1. The table excludes fraternal and mutual benefit societies which represent about 1% of the insurance in Canada.

2. In addition to the active companies, the table includes eight inactive companies, one Canadian owned and seven non-resident, which were no longer writing new business in 1978. They did however, hold investment portfolios and life insurance in force and consequently are included.

Source: The Canadian Life Insurance Association.

Canadian owned companies generated 68% of 1978 premiums, control 70% of invested assets and carry 68% of the life insurance in force in Canada at the end of 1978.

## 2. Corporate Concentration

The 15 largest life insurers in Canada while representing only 9% of the active companies, accounted for 72% of the 1978 premium income. Table 14 opposite, lists these 15 companies in order of their 1978 Canadian premium income analyzed further to indicate their individual and group insurance and their individual and group annuity premium income.

In 1978, the 15 most active companies accounted for:

- 68.4% of individual life insurance premiums
- 70.4% of group life insurance premiums
- 62.5% of individual annuity premiums
- 86.2% of group annuity premiums
- 71.6% of total Canadian premiums.

This concentration can be examined in closer detail by focusing on each of the four segments of life insurance activity. Tables 15 to 18 which follow, list the companies which in 1978 received more than 5% of the premiums in each segment of the business.

**TABLE 14**  
**1978 PREMIUM INCOME IN CANADA**  
**BY AREA OF LIFE INSURANCE ACTIVITY**  
**FOR THE 15 MOST ACTIVE LIFE INSURANCE COMPANIES<sup>1</sup> IN CANADA**  
(\$ millions)

	Insurance		Annuity		Total
	Individual	Group	Individual	Group	
Total Premiums in Canada 1978 <sup>1</sup>	\$1,972	100.0%	\$1,066	100.0%	\$5,027
Sun Life	\$ 143	7.3%	\$129	12.1%	\$ 433
London Life	256	13.0	29	2.7	370
Mutual Life	142	7.2	109	10.2	338
Great West Life	76	3.9	57	5.4	326
Manufacturers Life	67	3.4	94	8.8	289
Canada Life	65	3.3	63	5.9	283
Metropolitan Life	177	9.0	12	1.2	241
Standard Life	38	1.9	25	2.3	237
Confederation Life	42	2.2	34	3.2	228
Prudential of America	120	6.0	18	1.7	200
North American Life	44	2.2	43	4.0	159
Crown Life	67	3.4	17	1.6	134
Excelsior Life	24	1.2	19	1.8	127
Prudential of Great Britain	75	3.8	4	0.4	119
Desjardins Mutual Life	12	0.6	13	1.2	118
Total of 15 Companies	\$1,348	68.4%	\$666	62.5%	\$3,602
					86.2%
					71.6%

1. Excludes fraternal and mutual benefit societies.

Source: Report of the Superintendent of Insurance, Ottawa, 1978.  
Canadian Life Insurance Association.

**TABLE 15**  
**INDIVIDUAL LIFE INSURANCE**  
**COMPANIES WITH MORE THAN FIVE PERCENT OF**  
**1978 CANADIAN PREMIUMS**

Company	1978 Premiums (\$ million)	Percent of Total Individual Life Insurance Premiums
London Life Insurance	\$256	13.0%
Metropolitan Life Insurance	177	9.0
Sun Life Assurance	143	7.3
Mutual Life Assurance	142	7.2
Prudential Insurance of America	120	6.0
Five most active companies	<u>\$838</u>	<u>42.5%</u>

Source: Report of the Superintendent of Insurance, Ottawa 1978.

Individual life insurance premiums in Canada for 1978 were \$1,972 million. The five most active companies in this segment accounted for 42.5% of the total with one company, London Life, accounting for 13%. Metropolitan Life and Prudential of America are branch operations of foreign companies operating in Canada. Together they account for 15.0% of the total individual life insurance premiums in 1978.

**TABLE 16**  
**GROUP LIFE INSURANCE**  
**COMPANIES WITH MORE THAN FIVE PERCENT OF**  
**1978 CANADIAN PREMIUMS**

Company	1978 Premiums (\$ million)	Percent of Total Group Life Premiums
Sun Life Assurance	\$ 88	11.0%
Desjardins Mutual	76	9.5
Great West Life Assurance	67	8.4
Canada Life Assurance	57	7.1
Confederation Life Insurance	46	5.7
Five most active companies	<u>\$334</u>	<u>41.7%</u>

Source: Report of the Superintendent of Insurance, Ottawa 1978.

Group life insurance premiums in Canada in 1978 were \$801 million. The five most active companies accounted for 41.7% of the Canadian premiums with the most active company, Sun Life Assurance, accounting for \$88 million of 11% of the volume. All five companies are Canadian owned.

Individual annuity premiums in Canada in 1978 were \$1,066 million. The six most active companies accounted for 48.2% of this total. Five of the six companies are Canadian owned. The foreign-owned, Dominion Life As-

**TABLE 17**  
**INDIVIDUAL ANNUITY**  
**COMPANIES WITH MORE THAN FIVE PERCENT OF**  
**1978 CANADIAN PREMIUMS**

Company	1978 Premiums (\$ million)	Percent of Total Individuals Annuity Premiums
Sun Life Assurance	\$129	12.1%
Mutual Life Assurance	109	10.2
Manufacturers Life Insurance	94	8.8
Canada Life Assurance	63	5.9
Dominion Life Assurance	62	5.8
Great West Life Assurance	57	5.4
Six most active companies	<u>\$514</u>	<u>48.2%</u>

Source: Report of the Superintendent of Insurance, Ottawa 1978.

insurance Company is the only company included in this series of tables which did not have over \$100 million in total premiums in 1978 and is not included in the list of the fifteen largest insurers. In 1978 Dominion Life received total Canadian premiums of \$93 million and thus individual annuities accounted for two-thirds of its business.

**TABLE 18**  
**GROUP ANNUITY**  
**COMPANIES WITH MORE THAN FIVE PERCENT OF**  
**1978 CANADIAN PREMIUMS**

Company	1978 Premiums (\$ million)	Percent of Total Group Annuity Premiums
Standard Life Assurance	\$171	14.4%
Great West Life Assurance	126	10.6
Manufacturers Life Insurance	120	10.1
Confederation Life Insurance	106	8.9
Canada Life Assurance	98	8.3
Sun Life Assurance	73	6.1
Six most active companies	<u>\$694</u>	<u>58.4%</u>

Source: Report of the Superintendent of Insurance, Ottawa 1978.

Group annuity premiums in Canada in 1978 were \$1,188 million. The six most active companies accounted for 58.4% of this total. The most active company, Standard Life Insurance with 14.4% of the Canadian group annuity premiums, is a branch operation of a British mutual company. The remaining five companies are all Canadian owned.

In addition to the concentration of business among relatively few companies, companies themselves may tend to concentrate in a specific segment of the life insurance business. Some companies like Sun Life and Great



West Life maintain a balanced book of business while others tend to specialize. Table 19 presents a summary by the four major segments of life insurance of the extent to which the 15 largest companies concentrate in a particular market segment.

TABLE 19  
COMPANIES WITH CANADIAN PREMIUMS INCOME IN EXCESS  
OF \$100 MILLION IN 1978 AND WITH 50 PERCENT  
OF THEIR PREMIUMS FROM ONE SEGMENT OF THE BUSINESS  
(\$ million)

Market Segment/Company	Total 1978 Canadian Premium	Market Segment	
		1978 Premiums	Percent Concentration
Individual Life Insurance			
Metropolitan Life	\$241	\$177	73.8%
London Life	370	256	69.2
Prudential of Great Britain	119	75	63.6
Prudential of America	200	120	60.0
Crown Life	134	67	50.0
Group Life Insurance			
Desjardins Mutual	118	76	64.4
Individual Annuity			
Dominion Life <sup>1</sup>	93	62	66.7
Group Annuity			
Standard Life	237	171	71.8

1. Dominion Life did not have premium income in excess of \$100 million in 1978, but is included because of its degree of concentration in individual annuities.

Source: Report of the Superintendent of Insurance, Ottawa, 1978.

Three of the five companies, Metropolitan Life, Prudential of Great Britain and Prudential of America which concentrate on individual life insurance are branch operations of foreign companies and accounted for 18.8% of the individual insurance premiums in Canada in 1978.

Desjardins Mutual, a Canadian company is the only company with more than 50% of its premium income from group life insurance. Desjardins received 9.5% of the total group life premiums Canadians paid in 1978, second only to Sun Life which accounted for 11% of the total. Desjardins writes most of its business in the Province of Quebec with only about 3% of its premium income from Ontario.

As previously noted, Dominion Life Assurance Company received 66.7% of its total premium income of \$93 million in 1978 from individual annuities.

Standard Life is a branch of a foreign operation and received \$171 mil-

lion or almost 72% of its premium income from its group annuity business. This firm accounted for 14.4% of the total of this market segment in 1978.

It is apparent that not all companies participate actively in all areas of life insurance. Certain companies concentrate their efforts in specific market segments and likely as well in particular portions of those markets although statistics are not available to support this observation.

### 3. Stock and Mutual Companies

Life insurance companies can be incorporated as either stock or mutual companies. A stock company has an authorized and issued share capital which in part finances the operation. The shareholders own the company and elect at least a portion of the board of directors. Shareholders receive a return on their investment by way of dividends. Both the federal and Ontario Insurance Acts place restrictions on dividends to shareholders and the election of directors in certain circumstances. The Canadian and British Insurance Companies Act stipulates that participating policyholders must receive in the form of policy dividends a minimum of 90% to 97½% of distributed profits from the participating policies, depending on the size of the company. This restricts the shareholders to receiving dividends from the balance of the distributed profits from participating policies and from the profits from non-participating policies. This Act also stipulates that a minimum of one-third of the board of directors must be elected from and by the participating policyholders. These policyholder directors have the same privileges and obligations as shareholder directors.

A mutual company has neither authorized capital nor shareholders. It is owned by the participating policyholders who share in all of the company's profits and who elect a board of policyholder directors.

Table 20 presents data concerning the life insurance companies operating in Canada in 1978 by ownership and method of incorporation.

TABLE 20  
OWNERSHIP OF LIFE INSURANCE COMPANIES  
OPERATING IN CANADA IN 1978

Nationality	Mutual	Stock	Total
Canadian Owned	27	32	59
Canadian Incorporated, Foreign Owned	—	25	25
Non-Resident	27	66	93
	54	123	177

The table includes 169 active and eight inactive life insurance companies and excludes fraternal and mutual benefit societies.

Source: The Canadian Life Insurance Association.

It is worth noting the table does not show any Canadian incorporated, foreign-owned mutual companies. As discussed, the participating policyholders own a mutual life insurance company. This poses the question “what happens if a Canadian incorporated mutual company has more participating policyholders outside Canada than inside—is the company still Canadian?” Technically, the company is not controlled by a majority of persons who are ordinarily resident in Canada. The directors must still be Canadian citizens, however, as prescribed by both the federal and provincial insurance legislation. In practice these companies apply for exemption from regulations directed at foreign controlled companies and in most cases the exemption is granted. For example, the Canadian incorporated mutual companies are exempt from the Foreign Investment Review Act.

The above situation should be distinguished from the one in which a foreign mutual life company opens a branch operation in Canada. The 27 organizations of this kind carrying on business are “owned” by non-residents.

#### 4. Participating and Non-Participating Policies

Both mutual and stock companies may issue participating and non-participating policies. Participating life insurance policies entitle the policyholders to receive “policyholder dividends”. Premium calculations for participating policies are normally based on more conservative assumptions concerning operating costs and investment income than is the case for non-participating policies. As a consequence, for identical coverage, the gross premium tends to be higher for participating than for non-participating life insurance protection.

Policyholder dividends paid to participating policyholders are in fact a return or reduction of the premiums originally paid. They reflect the difference between mortality, investment income and expenses as projected

TABLE 21  
1978 CANADIAN PREMIUM INCOME<sup>1</sup> BY  
PARTICIPATING AND NON-PARTICIPATING COVERAGE  
(\$ million)

	Participating	Non-Participating	Total
Individual Insurance	\$1,542	\$ 442	\$1,984
Individual Annuity	223	842	1,065
Group Insurance	390	416	806
Group Annuity	205	983	1,188
	<u>\$2,360</u>	<u>\$2,683</u>	<u>\$5,043</u>

1. Total premiums are slightly higher than in other tables in this section of this Chapter, since the foreign portion of the business of a few small companies has not been eliminated.

Source: Canadian Life Insurance Association.

when the premiums were established and the actual mortality, investment income and expenses experienced by the company.

Table 21 summarizes the 1978 premium income of life insurers in Canada both by type of life insurance and by type of policy, either participating or non-participating. In individual insurance, the greatest premium income is from participating policies. Group life insurance premiums were about equally participating and non-participating, but because of the different sizes of group policies, the premiums may not be indicative of the number of policies which are participating. The majority of annuities, both individual and group are non-participating.

More detailed analysis of participating and non-participating policies is limited by the availability of data to individual life insurance only.

TABLE 22  
INDIVIDUAL LIFE INSURANCE IN FORCE<sup>1</sup>  
IN CANADA AT DECEMBER 31, 1978 BY  
PARTICIPATING AND NON-PARTICIPATING COVERAGE  
(\$ million)

	Participating	Non-Participating	Total
Whole Life	\$ 67,894	\$11,810	\$ 79,704
Endowment	16,407	625	17,032
Term	27,319	56,085	83,404
Total	<u>\$111,620</u>	<u>\$68,520</u>	<u>\$180,140</u>

1. Amounts are gross, for federally registered companies only.

Source: Report of the Superintendent of Insurance, Ottawa 1978.

Table 22 presents an analysis of individual life insurance in force at December 31, 1978 for whole life, endowment and term protection. Permanent insurance, that is whole life and endowment, to the extent of \$84.3 billion or 87% of a total of \$96.7 in force, are in the form of participating policies at December 31, 1978. In the case of term insurance however, 67% of the insurance in force at the end of 1978 is non-participating.

Table 23 on the following page summarizes as at December 31, 1978 the individual life insurance in force for the 15 companies with over \$100 million in Canadian premiums as between participating and non-participating coverage. The companies have been categorized as either mutual, stock or New York registered companies.

In the mutual companies, \$51.8 billion of \$66.1 billion of individual insurance in force or 78% of the total was in participating policies. Of the non-participating insurance in force, 90% was in term policies.

In contrast, the stock companies had \$26.1 billion of a total of \$44.4 billion, or 59% of their individual insurance in force in participating insurance, with 41% in non-participating policies.



TABLE 23

INDIVIDUAL LIFE INSURANCE IN FORCE AT DECEMBER 31, 1978  
BY PARTICIPATING AND NON-PARTICIPATING COVERAGE  
FOR THE 15 MOST ACTIVE LIFE INSURANCE COMPANIES IN CANADA

Companies	Participating			Non-Participating			Individual Insurance In Force
	Whole Life	Endowment	Term	Whole Life	Endowment	Term	
Mutual Companies							
Sun Life Assurance	\$ 9,185	\$ 3,206	\$ 3,486	\$ 106	\$ 3	\$ 2,295	\$ 18,281
Mutual Life Assurance	4,725	403	5,006	42	-	422	10,598
Manufacturers Life Insurance	6,278	1,252	1,402	694	140	4,185	13,951
Canada Life Assurance	3,042	915	1,087	174	12	1,703	6,933
Standard Life Assurance	598	386	515	102	1	465	2,067
Confederation Life Insurance	3,466	865	1,342	119	4	1,065	6,861
North American Life Assurance	3,142	212	469	33	-	2,451	6,307
Desjardins Mutual Life Assurance	494	22	278	-	-	325	1,119
Total	\$30,930	\$ 7,261	\$13,585	\$1,270	\$160	\$12,911	\$ 66,117
Stock Companies							
London Life Insurance	\$10,140	\$ 1,238	\$ 2,690	\$ 788	\$ 8	\$ 3,677	\$ 18,541
Great West Life Assurance	2,838	819	606	585	31	3,038	7,917
Crown Life Insurance	2,512	784	517	2,592	99	6,036	12,540
Excelsior Life Insurance	463	168	114	318	12	772	1,847
Prudential of Great Britain	2,012	716	486	47	2	293	3,556
Total	\$17,965	\$ 3,725	\$ 4,413	\$4,330	\$152	\$13,816	\$ 44,401
New York Registered Companies							
Metropolitan Life Insurance	\$ 4,507	\$ 2,477	\$ 2,807	\$ 0	\$ 0	\$ 0	\$ 9,791
Prudential Insurance of America	3,672	627	2,270	0	0	0	6,569
Total	\$ 8,179	\$ 3,104	\$ 5,077	\$ 0	\$ 0	\$ 0	\$ 16,360
Total 15 Companies	\$57,074	\$14,090	\$23,075	\$5,600	\$312	\$26,727	\$126,878

Source: Report of the Superintendent of Insurance, Ottawa 1978.

The New York registered companies are branch operations of foreign life insurance companies licensed to sell in Canada. They are shown separately on the table to highlight the fact that New York registered companies are permitted to sell only participating or non-participating insurance but not both. Metropolitan Life and Prudential Insurance of America both sell only participating policies.

## **5. International Operations**

Canadian incorporated life insurance companies operating internationally insure more than two million people with \$65 billion of life insurance in force outside Canada. The life insurance in force outside Canada represents 22% of the world wide in force of federally and provincially incorporated life insurers at the end of 1977. In 1977 Canadian companies sold \$11.4 billion of life insurance outside Canada for \$1,162 million in premiums and paid \$667 million in benefits and dividends. At the end of 1977, Canadian life insurance companies had \$7.4 billion invested in other countries on behalf of foreign policyholders. The foreign investments represent approximately 26% of the total assets of all federally registered Canadian life companies.

The largest foreign buyers of life insurance from Canadian companies are residents of the United States. In 1977 American residents purchased 81% of the total insurance sold outside Canada by Canadian incorporated life insurance companies while residents of Britain and Ireland purchased 13% and residents of the Caribbean and Latin America bought 5% of the total.

Many of the life insurance companies operating internationally conduct their business from headquarters in Ontario.

## **6. Diversification of Life Insurance Companies**

Legislation provides certain guidelines for the quality, form and amount of investments allowed by life insurance companies. A life company, for example is prohibited from owning more than 30% of another company's stock, unless it is an authorized subsidiary or real estate affiliate. Because a life insurance company must guarantee future policy benefits, risk minimization in an investment portfolio is of concern to a life insurer and justifies the codification of investment guidelines in legislation.

It is this rationale that also justifies the regulation of life insurance companies if they wish to diversify. Any attempt to diversify by acquiring subsidiary companies requires the prior approval of the Superintendent of Insurance, and in some cases, the Minister of Finance. Legislation requires regular reporting of the financial results of the subsidiary and, with the exception of real estate affiliates, that a controlling interest be held by the parent life company.

At the end of 1978, 14 life companies had more than 60 real estate subsidiaries or affiliates and 16 companies had subsidiaries in fields ancillary to their life insurance business mainly in computer services and investment management.

## **7. Trade Associations**

The life insurance companies in Canada are served by a variety of company, professional and quasi-professional organizations. The following list<sup>1</sup> identifies the major organizations and highlights the function or service offered to the life companies.

1. The Canadian Life Insurance Association (CLIA). A voluntary trade organization, the CLIA speaks for the life insurance business as a whole. It monitors and assists in legislative developments, and serves as a clearing house for industry problems. The CLIA also provides research and information about the life insurance business.
2. The American Council of Life Insurance (ACLI). The ACLI is the American counterpart of the CLIA. Canadian insurers operating in the United States are able to call on the ACLI for information.
3. The Life Office Management Association (LOMA). LOMA is an educational association based in the United States. Its objective is to improve the management of life insurance companies through an exchange of experience and research.
4. The Life Insurance Marketing Research Association (LIMRA). LIMRA is an American based market and manpower research association. Its objective is to provide marketing officers with information on all aspects of agency management. Even though LIMRA is a American association, it conducts surveys and provides information on the Canadian market.
5. Medical Information Bureau (MIB). An American based association, MIB assists its members in conducting a confidential interchange of information in order to expedite underwriting, improve accuracy and prevent fraud.
6. The Life Underwriters Association of Canada (LUAC). LUAC is the professional association for licenced life insurance agents. It acts as a training and educational body, and maintains and administers a code of professional ethics.
7. The Life Insurance Managers Association of Canada (LIMAC). LIMAC is an association of insurance branch managers who are active in building career sales organizations.
8. The Canadian Institute of Actuaries (CIA). CIA is the professional

1. Source: The Canadian Life Insurance Association.

body of actuaries in Canada. Its objectives are to advance and develop the actuarial science, promote its application and to maintain a standard of conduct among its members.

9. The Life Insurance Institute of Canada (LIIC). LIIC assists LOMA in administering its programs in Canada.
10. Canadian Home Office Life Underwriters' Association (CHOLUA). CHOLUA provides a forum for discussing problems relating to home office underwriting.
11. Canadian life Insurance Medical Officers Association (CLIMOA). Members are physicians employed in the insurance industry. CLIMOA provides a liaison between the medical profession and the insurance industry.

## 8. Assets of Life Insurance Companies

Table 24 summarized data concerning the assets held by life insurance companies in Canada as at the end of 1970 and each of the years 1974 to 1978.

**TABLE 24**  
**ASSETS OF LIFE INSURANCE COMPANIES IN CANADA<sup>1</sup>**  
(\$ millions)

	1970	1974	1975	1976	1977	1978 <sup>2</sup>
Bonds	\$ 5,697	\$ 7,817	\$ 8,710	\$ 9,681	\$10,991	\$12,406
Stocks	1,107	2,052	2,535	2,848	2,983	3,694
Mortgage Loans	6,873	8,705	9,486	10,521	11,909	13,255
Real Estate	737	1,215	1,298	1,421	1,504	1,549
Policy Loans	799	1,114	1,205	1,293	1,352	1,443
Cash	139	168	273	318	444	438
Other Assets	321	585	590	677	781	1,141
	<u>\$15,673</u>	<u>\$21,656</u>	<u>\$24,097</u>	<u>\$26,759</u>	<u>\$29,964</u>	<u>\$33,926</u>

1. Data excludes fraternal and mutual benefit societies which accounts for about 1 percent of life insurance in Canada.

2. In 1978, the insurance industry adopted a change in the basis of accounting for certain assets. The resulting increase of approximately \$100 million is reflected in the 1978 figures.

Source: Canadian Life Insurance Facts, 1979 edition.

At the end of 1978, total assets of life insurance companies were almost \$34 billion, more than double the total at the end of 1970. Fixed income securities such as bonds and mortgages, represented 75% of all assets. At the end



of 1978, life insurance companies excluding fraternal and mutual benefit societies, held the following portions of Canadian securities:<sup>1</sup>

- 13% of all mortgages
- 30% of Canadian corporate bonds
- 16% of Canadian municipal bonds
- 11% of Canadian provincial bonds
- 8% of Government of Canada market securities.

### 9. Policy Reserves

Policy reserves are the amounts which, together with future premiums and investment income are calculated to be necessary to meet the benefits guaranteed to policyholders. At the end of 1978, policy reserves were equal to approximately \$26.0 billion or about 76.2% of the total assets of Canadian life insurance companies.

The portions of the policy reserves for the major types of business are set out in the following table:

TABLE 25  
POLICY RESERVES BY TYPE OF INSURANCE<sup>1</sup>

	1974	1978
Life Insurance:		
Individual	54.6%	43.3%
Group	<u>2.7</u>	<u>2.7</u>
	<u>57.3%</u>	<u>46.0%</u>
Annuities:		
Individual	11.3%	18.3%
Group	29.9	34.0
Settlement and Disability	<u>1.5</u>	<u>1.7</u>
	<u>42.7%</u>	<u>54.0%</u>
Total	<u>100.0%</u>	<u>100.0%</u>

1. Percentages are based on federally registered companies and do not include the provincially incorporated companies or fraternal and mutual benefit societies which together account for about 7 percent of the life insurance in Canada.

Source: Canadian Life Insurance Facts, 1975 and 1979 Editions.

### 10. Other Liabilities of Life Insurance Companies

Deposits by policyholders and dividends payable to policyholders as at the end of 1978 amounted to more than \$2.7 billion. Other liabilities, including provisions for staff pension funds, amounted to a further \$1.1 billion. In total approximately 11.1% of the total assets of life insurers as at the end of 1978 were required to cover these liabilities.

1. Source: Canadian Life Insurance Facts, 1979 Edition.

## 11. Equity of Life Insurance Companies

The provision for special contingencies and the unappropriated surpluses of both mutual and stock companies together with the paid-up capital of companies with share capital amounted to in excess of \$4.3 billion as at the end of 1978.

## 12. Premium Income

Table 26 presents a summary of premium income for the life insurance industry excluding fraternal and mutual benefit societies for several recent years.

**TABLE 26**  
**LIFE INSURANCE PREMIUM INCOME IN CANADA<sup>1</sup>**  
(**\$ millions**)

	1960	1970	1974	1975	1976	1977	1978
Life Insurance							
Individual	\$660	\$1,128	\$1,404	\$1,543	\$1,670	\$1,799	\$1,972
Group	109	325	535	604	684	755	801
	<u>769</u>	<u>1,453</u>	<u>1,939</u>	<u>2,147</u>	<u>2,354</u>	<u>2,554</u>	<u>2,773</u>
Annuities:							
Individual	33	126	542	634	772	880	1,066
Group	151	311	618	735	884	1,039	1,188
	<u>184</u>	<u>437</u>	<u>1,160</u>	<u>1,369</u>	<u>1,656</u>	<u>1,919</u>	<u>2,254</u>
	<u>\$953</u>	<u>\$1,890</u>	<u>\$3,099</u>	<u>\$3,516</u>	<u>\$4,010</u>	<u>\$4,473</u>	<u>\$5,027</u>

1. Data excludes fraternal and mutual benefit societies which account for about 1 percent of the life insurance in Canada.

Source: Canadian Life Insurance Facts, 1979 edition.

The total Canadian premium income for 1978 of \$5,027 million, represented a 12% increase over 1977 and a 166% increase over 1970. The largest source of premium income in 1978 was for individual life insurance policies at \$1,972 million. Group annuities, for the most part pensions, were next largest at \$1,188 million.

The figures in the table show clearly the growth in the market for annuities. Total annuity premiums increased by 94% from 1974 to 1978. The individual contract premiums increased at a slightly greater rate than the group contract premiums, 97% compared to 92%. Premiums for life insurance which provides death benefits, however, increased only 43% in the period 1974 to 1978. Group life insurance premiums increased at a greater rate than individual life premiums over the five year period at 50% compared to 40%.

Table 27 presents a summary of the premium income of life insurance companies by geographical regions in Canada.

**TABLE 27**  
**PREMIUM INCOME BY REGION OF**  
**LIFE INSURANCE COMPANIES IN CANADA<sup>1</sup>**

	1977		1978	
	\$Millions	%	\$Millions	%
British Columbia	\$ 367	8.2%	\$ 412	8.2%
Prairie Provinces	684	15.3	784	15.6
Ontario	1,874	41.9	2,116	42.1
Quebec	1,279	28.6	1,433	28.5
Atlantic Provinces	269	6.0	282	5.6
	<u>\$4,473</u>	<u>100.0%</u>	<u>\$5,027</u>	<u>100.0%</u>

1. Data excludes fraternal and mutual benefit societies which account for about 1 percent of life insurance in Canada.

Source: Canadian Life Insurance Facts, 1978 and 1979 Editions.

### 13. Benefit Payments

Table 28 presents a summary of payouts by type of benefit for several years.

**TABLE 28**  
**LIFE INSURANCE BENEFIT PAYMENTS IN CANADA<sup>1</sup>**  
(\$ millions)

	1970	1974	1975	1976	1977	1978
Death Claims	\$ 453	\$ 634	\$ 703	\$ 774	\$ 841	\$ 909
Matured Endowments	74	84	82	87	85	87
Disability Claims	14	22	24	27	34	36
Surrender Values	269	279	272	309	321	366
Policyholder Dividends	234	310	380	390	433	484
Annuity Payments	260	441	488	650	759	991
Total Benefits	<u>\$1,304</u>	<u>\$1,770</u>	<u>\$1,949</u>	<u>\$2,237</u>	<u>\$2,473</u>	<u>\$2,873</u>

1. Data excludes fraternal and mutual benefit societies which account for about 1 percent of life insurance in Canada.

Source: Canadian Life Insurance Facts, 1979 edition.

In 1978, life insurance companies paid a total of \$2,873 million in policy and contract benefits. Actual death claims represented only 32% of total benefits paid, second to the payment on annuity contracts at 34% of the total. In years prior to 1978 however, death claims were the largest single benefit, with annuities second. The 1978 figures again reflect the growth in annuity contracts during the past few years.

From 1974 to 1978, total benefit payments increased by 62%. The largest increase was in annuity payments, up 125%. Policyholder dividends increased 56% while death claims increased by 43%.

## 14. Sources of Uses of Income

Premium income is the greatest source of revenue of life insurance companies in Canada, representing about two-thirds of the total. The balance is mainly from interest and dividend income from the billions of dollars invested by the industry.

Table 30 presents an analysis of data provided by CLIA of the sources and uses of one dollar of income for Canadian life insurance companies from their world-wide operations.

TABLE 29  
SOURCES AND USES OF \$1.00  
BY CANADIAN LIFE INSURANCE COMPANIES<sup>1</sup>

	1960	1970	1975	1976	1977	1978
<b>Sources</b>						
Policyholder Premiums	73.0¢	68.5¢	66.8¢	67.6¢	67.7¢	65.4¢
Investment Income	27.0	31.5	33.2	32.4	32.3	34.6
	<u>100.0¢</u>	<u>100.0¢</u>	<u>100.0¢</u>	<u>100.0¢</u>	<u>100.0¢</u>	<u>100.0¢</u>
<b>Uses</b>						
Policyholder Benefits	46.8¢	49.1¢	39.3¢	39.1¢	38.1¢	37.7¢
Investment for Policyholder	35.4	30.9	42.1	43.1	44.6	45.6
Taxes	1.9	3.5	2.7	2.1	2.4	2.1
Operating Expenses	15.7	16.2	15.8	15.4	14.6	14.4
Shareholders <sup>2</sup>	.2	.3	.1	.3	.3	.2
	<u>100.0¢</u>	<u>100.0¢</u>	<u>100.0¢</u>	<u>100.0¢</u>	<u>100.0¢</u>	<u>100.0¢</u>

1. Data are for Canadian life insurance companies world-wide operations and exclude fraternal and mutual benefit societies which account for about 1 percent of life insurance in Canada.

2. Payments to shareholders include all payments to shareholders in relation to the revenues of all companies, mutual and stock. Mutual companies are owned by the policyholders, and dividends paid to policyholders are treated as policyholder benefits. In 1978, over 16% of all benefits paid were in the form of policyholder dividends. If payments to shareholders were related to the revenues of only those companies with share capital, the shareholders would have received 0.8¢ and 0.5¢ respectively in 1977 and 1978 of the total income of \$1.00:

Source: Canadian Life Insurance Facts, 1979 edition.





## CHAPTER 3

### Legislation and Supervision

#### **A. FEDERAL AND PROVINCIAL GOVERNMENT RESPONSIBILITIES**

##### **1. History of Insurance Regulation in Canada**

During the course of its hearings the Committee had the pleasure of meeting with Mr. K. R. MacGregor, Chairman of the Board of Directors of The Mutual Life Assurance Company of Canada and former Federal Superintendent of Insurance. During his presentation, Mr. MacGregor traced the history of insurance legislation in Canada and in particular a number of matters related to the division of responsibilities between the federal and provincial authorities.

Mr. MacGregor explained that to understand the history of insurance regulation in Canada it is necessary to appreciate that the underlying thrust of The British North America Act was to provide a constitution for Canada in which the federal government would be charged with matters of common interest to the whole country and local governments would be charged with the control of local matters in their respective sections. Unfortunately no specific mention was made regarding insurance in the Act.

Following Confederation, the first Federal Insurance Act was passed in 1868 and provided that all insurance companies excepting provincially incorporated companies operating solely in the province of incorporation must secure a licence from the Minister of Finance, make deposits and file annual statements. In 1910 a Federal Department of Insurance was established to administer the Federal Insurance Act with the department under the supervision of a Superintendent of Insurance responsible to the Minister of Finance.

Likewise, in Ontario in 1876 the first Insurance Act for the Province was passed providing that all insurance companies without a federal licence must secure a licence from the Provincial Treasurer, make deposits, file annual reports and submit to inspection. In 1879 Ontario appointed an Inspector of Insurance to administer its Insurance Act. In 1914 a Department of Insurance headed by a Superintendent of Insurance was established to administer the Act and to report to a Cabinet Minister. In the years since they were first enacted, amendments had been made to both the Federal and Ontario Insurance Acts and various cases had been heard by the Supreme Court and Privy Council that have led to some clarification of the division of responsibilities between the Federal and Ontario jurisdictions.

In his 1962 submission to the Royal Commission on Banking and Finance, Mr. MacGregor, then Federal Superintendent of Insurance stated:

“Even though the existing situation is presently satisfactory from the practical standpoint, it would nevertheless be desirable if the situation were confirmed in the British North America Act. Under existing conditions, it is always possible that uncertainties may arise concerning the respective authority of Parliament and the provincial legislatures which should be avoided in the interest of all concerned. Much time and money have already been spent over the years in attempts to determine or clarify the respective powers of the federal and provincial governments in this field and it would be unfortunate if this should ever happen again in any substantial way. Nothing that has been said above is intended to minimize or gloss over the fact that the Privy Council’s decisions respecting the business of insurance in Canada have sometimes lent much support to the provincial side but at the same time it must be admitted all around that such decisions have sometimes been difficult to understand and have tended to confuse rather than clarify the situation.”

Mr. MacGregor reiterated to the Committee his continuing concern for the need to clarify in the constitution exactly where jurisdiction for insurance matters lies.

In 1932 one of the more significant changes took place when the Dominion Insurance Act was repealed and replaced by three new Acts, the Canadian and British Insurance Companies Act, the Foreign Insurance Companies Act and the Department of Insurance Act. These three new Acts dealt with substantially the same matters as the former Insurance Act but in a different format except that some previously offending provisions of The Insurance Act relating to—statutory conditions in life insurance contracts; advertisements of capital and surplus; agent’s commissions and salaries; estimates of dividends; and approval of policy forms had been deleted. These three Acts have been amended in minor ways from time to time but have been reproduced in substantially their same form in the Revised Statutes of 1952 and 1970 and are the Acts today.

In sum, in 1932, the Federal Acts excluded references to the condition of insurance contracts, concentrating instead on matters relating to the solvency of companies registered under the Acts. Further, British and foreign companies and fraternal benefit societies would be unable to carry on the business of insurance in Canada unless registered under this legislation, which among other things required the maintenance in Canada of assets adequate to meet liabilities, and all companies and fraternal benefit societies registered under the Acts, must satisfy the Minister of Finance of their soundness, solvency and boni fides, make full and complete annual returns of their business and affairs and submit to examination by the Superintendent of Insurance.

Broadly the Federal Government now concerns itself almost exclusively with the financial soundness of non-Canadian companies and of

Canadian-incorporated companies which are registered federally. The provincial authorities concern themselves with these and all other insurance matters.

## **2. Federal Responsibilities**

As stated, the main thrust of the Canadian and British Insurance Companies Act and the Foreign Insurance Companies Act is to ensure that companies continue to be solvent and remain in a position to carry out their obligations to policyholders as they become due. In this regard, the two Acts set out rules providing for standards for the valuation of assets and reserve liabilities. They set out categories, qualities and amounts of investments which may be permitted. Rules also are provided for monitoring compliance with the laws and regulations, including the filing of annual financial statements and a regular examination of company records and operations every three years.

## **3. Provincial Responsibilities**

The span of the provincial responsibilities is much broader than that outlined above for the federal government. Their responsibilities include not only those matters that relate to the solvency of insurance companies but also a number of matters over which they have exclusive jurisdiction in the area of insurance contracts. In addition, they have exclusive jurisdiction to licence insurance agents, brokers and adjusters. In practice, most provincial governments confine their detailed review of the solvency and related considerations to provincially incorporated life insurance companies and rely on the federal supervisory authorities to review the solvency and related matters of federally incorporated companies. In general, the provincial rules regarding matters of solvency, investments, etc. are similar to the federal rules.

## **4. Association of Superintendents of Insurance of the Provinces of Canada**

The potential for havoc within the life insurance industry if each of the provincial jurisdictions developed its own legislation without at least some consistency across the country is apparent. The provincial authorities recognizing the problem organized The Association of Superintendents of Insurance of the Provinces of Canada in 1917 with the purpose of "promoting uniformity in insurance laws".

As a result of their meetings the Association has been quite successful in developing a uniformity of certain portions of the legislation in what is referred to as the "Uniform Life Insurance Act" which Act does not exist in fact but rather forms a part of each province's general insurance act, in all provinces except Quebec. The last revision to the "Act" was in 1962 but it is under review at the present time.



The "Uniform Life Insurance Act" is Part V of The Insurance Act of Ontario, R.S.O. 1970 as amended. It contains sections dealing with:

- interpretation and application
- issuance of policy and contents thereof
- conditions governing formation of contracts, including a definition of insurable interest, when a contract takes effect, periods of grace, duty to disclose, incontestability, misrepresentation, effects of suicide, reinstatement of a contract, etc.
- designation of beneficiaries, including the changes in designation, revocation, etc.
- dealings with contract during lifetime of insured, including such matters as entitlement to dividends, assignment of an insurance contract, etc.
- minors
- proceedings under contract including matters relating to proof of claim, place of payment, declarations as to sufficiency of proof, court orders, simultaneous deaths, where beneficiary is a minor, etc.
- miscellaneous provisions including presumption against agency and insurer giving information.

In addition to the development of a "Uniform Life Insurance Act", The Association of Provincial Superintendents have in recent years expanded their activities by issuing a series of Guidelines dealing with various matters concerning the conduct of the insurance business. These guidelines have no force in law but are prepared by the Association to indicate to the industry how it is expected to act regarding the matters covered in the Guidelines. At present the Guidelines in force are as follows:

- (a) Basis of valuation for securities held by insurers at the end of the calendar year.
- (b) Accident and sickness guidelines:
  - mass advertising of life, accident and sickness insurance,
  - group accident insurance and group sickness insurance,
  - disclosure relative to accident insurance and sickness,
  - disclosure of benefits, limitations and exclusions in individual policies of accident and sickness insurance.
- (c) Life insurance:
  - rules governing variable contracts of life insurers,
  - rules governing group life insurance,
  - rules governing creditor's group insurance.

## **B. ONTARIO REGULATORY FRAMEWORK AND THE SUPERINTENDENT'S OFFICE**

The Insurance Act, R.S.O. 1970 as amended, together with the Regulations thereunder set out the statutory authority for the supervision of insurance in Ontario.

### **1. The Insurance Act**

As it pertains to the life insurance segment of the industry, the Act refers to various matters among others, as follows:

#### ***Part I—Superintendent and His Duties***

Included in this Part are:

- 2.(1) “A Superintendent of Insurance shall be appointed who shall exercise the powers and perform the duties vested or imposed upon him by this or any other Act, shall have the general supervision of the business of insurance in Ontario and shall see that the laws relating to the conduct thereof are enforced and obeyed.”
- Other sections set out the books and records to be kept by the Superintendent; the duty of the Superintendent to determine the right of any insurer to be licenced; his right to inquire into matters concerning the contracts or financial affairs of insurers; his access to books, etc. of an insurer, agent, etc.
- 15(1) “The Superintendent shall visit personally, or cause a duly qualified member of his staff to visit, at least annually, the head office or chief office in Ontario of every licenced insurer, other than a mutual benefit society having fewer than 300 members and an insurer as to which he adopts the inspection of some other government, and he shall examine the statements of the condition and affairs of each such insurer filed under this Act, and make such inquiries as are necessary to ascertain its condition and ability to provide for the payment of its contracts as they mature and whether or not it has complied with all the provisions of this Act applicable to its transactions, and the Superintendent shall report thereon to the Minister as to all matters requiring his attention and decision.”
- Further sections concern the responsibility of the Superintendent to prepare for the Minister an annual report showing the particulars of each insurer; and to publish from time to time notices, reports and other matters considered by him to be in the public interest.

#### ***Part II—General Provisions Applicable to Insurers***

Included in this Part are sections dealing with:

- Licencing requirements for insurers.
- The scope of a life insurance licence.
- The capital requirements of a joint stock company before a licence will be granted.
- Documents to be filed by applicants for licence, including copies of all policy and application forms proposed to be used.
- Deposit requirements and related matters.
- Records and returns required of an insurer with particular reference to the annual statements and valuation of securities.
- Matters concerning life insurance reserves including the valuation of contracts of insurance; the methods of computation of reserves for life policies; the certificate of the actuary, etc.
- The requirement that every insurer shall maintain separate accounts for its participating and non-participating business.
- Requirements concerning the distribution of part of profits to participating shareholders from participating policies as distinguished from the part of profit derived from other sources.

### ***Part V—Life Insurance***

As noted above, this Part contains the “Uniform Life Insurance Act”.

### ***Part X—Fraternal Societies***

### ***Part XI—Mutual Benefit Societies***

### ***Part XII—Pension Fund Associations***

### ***Part XIV—Agents, Brokers and Adjusters***

Included in the Part are:

- Provisions dealing with the licencing of agents; the classes of licences; the issue and limitation of licences, etc.
- 342.(13) “No life insurance agent shall be licensed to act as agent for more than one insurer transacting life insurance . . . and no such agent shall represent himself to the public . . . as the agent of more than one such insurer, but where such an agent is unable to negotiate insurance on behalf of an applicant for insurance with the insurer for which he is the authorized agent, such agent has the right to procure such insurance from another insurer if such other insurer obtains in each case the consent in writing of the insurer for which such agent is the authorized agent, and files a copy of such consent with the Superintendent.”

- 356.(2) Which prohibits any insurer or agent from making any agreement concerning premiums to be paid for a policy other than is set forth in the policy or to pay, allow or give a rebate of the premium.
- 357.(1) Which prohibits twisting life insurance and reads as follows:
 

“Any person who induces or attempts to induce, directly or indirectly an insured to,

  - (a) lapse:
  - (b) surrender for cash paid up or extended insurance, or other valuable consideration: or
  - (c) subject to substantial borrowing whether in a single loan or over a period of time,

any contract with one insurer of life insurance that contains provision for cash value and paid-up values for the purpose of affecting a contract of life insurance with another insurer is guilty of an offence.”
- Provisions concerning misleading statements or coercion and refers to the Regulation as to replacement of an existing life insurance contract by another contract of life insurance.

### ***Part XVI—Amalgamation, Transfer and Reinsurance***

- This Part includes reference to the procedure that must be followed and the responsibility of the Superintendent in connection with the amalgamation of insurers if one of the contracting insurers is an insurer not incorporated or organized under the laws of Ontario.

### ***Part XVII—Investment***

- Included in this Part are sections dealing with the approved investments for insurance companies and the limitations that are placed on any specific type of investment.

### ***Part XVIII—Unfair and Deceptive Practices in the Business of Insurance***

#### ***Schedules to the Act***

- Also forming part of the Act are various schedules including Schedule D which deals with the minimum standards of valuation of life insurance contracts.

## **2. Regulations Under The Insurance Act**

Various regulations have been issued under The Insurance Act including:



### *Regulation 539—Licences of Insurance Agents*

- This Regulation deals with the requirements an applicant must satisfy before the Superintendent will issue a licence; the restrictions concerning the activities in which an agent may be involved and the Superintendent's authority to suspend or revoke a licence.

### *Regulation 526/71—Variable Insurance Contracts of Life Insurers*

- Included in this Regulation are such matters as the requirement to file variable insurance contracts with the Superintendent of Insurance at least 30 days before offering them to the public and some of the particulars concerning the contents of these contracts.

### *Regulation 519/73—Life Companies Special Share—Investment*

- This Regulation includes reference to any investments in foreign life corporation shares.

### *Regulation 831/74—Replacement of Life Insurance Contracts*

Included in this Regulation is:

- 2. "Every agent for an insurer shall
  - (a) obtain as part of each application for a contract of insurance a statement signed by the applicant stating whether replacement of a life insurance contract is intended; and
  - (b) prepare and forward to the insurer with each application for a life insurance contract a statement stating to the best of his knowledge whether replacement of a contract of life insurance is intended."
- The Regulation then sets out the procedures to be followed by every agent where replacement of a contract of life insurance is intended including reference to the forms that must be completed and the need to provide a comparison statement, etc.

## **3. The Superintendent's Office**

In his presentation to the Committee the Ontario Superintendent expanded on the activities of his department and the manner in which he and his staff administered certain provisions of The Insurance Act and the Regulations thereunder. Among other matters he provided details concerning:

### *The Licencing of Companies*

Including a summary of the organizations licensed as life insurers as at July 1979 under the Act as follows:

### *Life Insurers*

Federally Incorporated and Registered	52	
Foreign (Federally Registered)	74	
Ontario Incorporated	4	
Incorporated in Other Provinces	<u>8</u>	138

### *Fraternal Societies*

Foreign (Federally Registered)	17	
Federally Incorporated and Registered	15	
Ontario Incorporated	6	38

### *Mutual Benefit Societies*

Incorporated in Ontario	<u>52</u>	
<i>All Companies Licensed</i>	<u>228</u>	

In reply to a query regarding the number of new licenses issued in recent years, the Superintendent in a subsequent submission commented:

“Some difficulty has been experienced in obtaining figures for new companies entering the market. However, we have determined that for the ten year period from January 1, 1969 to December 31, 1978, 34 new life insurers were licensed as follows:

Federal and Foreign	29
Extra-Provincial	2
Ontario	1
Fraternal	2”

### *Examination of Companies*

The Superintendent's Office examines annually all Ontario incorporated life insurance companies and Ontario incorporated fraternal societies and a sample of mutual benefit societies. Further, the Federal Department of Insurance, after conducting its regular examination of federally registered life insurance companies *usually* files a certificate of solvency with the Ontario Department. The staff in the Superintendent's office also review (examine in the case of all provinces other than Quebec and recently British Columbia) annually the financial statements of all life insurers incorporated in a province other than Ontario and licensed to do business in Ontario.

The Superintendent indicated that the federal solvency standards and the minimal bases of actuarial reserve calculation had been changed in 1977 applicable to the reporting of life insurance companies for fiscal 1978. On-

tario had accepted the changes in principle and while no steps have been taken to revise the Ontario solvency standards as yet, the Superintendent indicated he believes Ontario will follow the Federal Department's lead and make the necessary changes to The Insurance Act and/or its Regulations soon. Frequent references are made throughout this Report to the nature and implications of the 1977 amendments to the federal legislation and the current status of the proposed amendments to the Ontario statutes.

Mr. Thompson concluded his remarks in this regard as follows:

"Although the Office of the Superintendent relies on the Federal Department of Insurance for insuring the solvency of the federal companies, it is understood that this Office is responsible to the Ontario policyholders in making sure that the promised insurance benefits would be paid to them when they are due. If the Office is in any doubt as to the capacity of a federal company to meet its obligation to Ontario policyholders, we shall certainly initiate actions, either on our own or in conjunction with federal and/or other provincial authorities."

### *Regulation of Life Contracts*

The Insurance Act requires all life insurers applying for a licence to file with their applications, copies of all policy forms and forms of application for insurance proposed to be used in Ontario. With the exception of variable insurance contracts there is no statutory requirement for filing new contract material devised for use by the insurer after receiving its licence in Ontario. However, the Superintendent does have the right under Section 91(1) of the Act to ask for any contract material at any time from a licenced insurer. In practice as well life insurers under a guideline set out by the Association of Superintendents file contract material respecting mass advertising of life insurance and on creditor's group insurance.

Some life insurers voluntarily file contract material for review by the Superintendent particularly in the case of new products that constitute a material departure from existing plans. In such cases the Office of the Superintendent endeavours to review and comment upon most of these filings. However since no formal approval is required the review in the past has been selective with emphasis either on certain types of products which have caused concern because of their nature and the methods used for marketing or on new products to assess their potential effects on the consumer.

### *Handling of Complaints*

The Office of the Superintendent handles consumer complaints through its Policy Service Section. In the year ended March, 1979 the Section handled 1,626 complaints, responded to 5,572 telephone inquiries, conducting 369 personal interviews. Of the 1,626 complaints, 125 related to life insurance—101 concerning individual policies and 24 concerning group policies.

The Superintendent identified the major areas of concern reflected in the complaints as follows:

- the matter of proper and adequate disclosure in the sale of an RRSP;
- the matter of inadequate explanation with respect to the front-end load, particularly regarding RRSPs;
- the matter of a proper administration of group policies—problems have arisen due to the poor definition of the respective obligations of the insurer and the employer or association/sponsor of the group. Generally all administrative responsibilities are delegated to the group policyholder who may or may not be fully conversant with all aspects of the group insurance contract. As a result a claim may be presented to the insurer and may be denied on the basis of some administrative mismanagement.
- the matter of proper disclosure with respect to the transfer of the value of annuity contracts.





## PART II

### LIFE INSURANCE PRODUCTS AND COVERAGE



## CHAPTER 4

### Individual Life Insurance Providing Death Benefits

#### A. INTRODUCTION

The spectrum of financial protection is broad, ranging from income maintenance during sickness or recovery from accident, to income protection in the case of unemployment, to income maintenance for dependants in the case of death or disability, through to income protection after retirement. The market overview in Chapter 2 demonstrated that the life insurance industry is a major participant in the private system of financial protection and that it has responded to the wide range of consumer needs in this area with a proliferation of types of insurance and annuity policies.

In this Chapter, the Committee takes a closer look at *individual* life insurance products, which provide death benefits. Within the proliferation of types of life insurance policies, the Committee focuses its attention on the principal forms of coverage, that is whole life, term and endowment insurance, and on the principal riders and options made available to consumers. Even within this narrowed focus are differences in policy provisions and in the determination of the interim and final values of the products bought from life insurers. These and further variations are meant to improve the consumer's choice of a product that is best suited to his individual circumstances. They represent the life insurance industry's continual effort at innovation, product improvement and, generally, at competition.

Nonetheless, in the opinion of some critics of the industry, the proliferation of types of policies is, at the least, confusing to the consumer and sometimes misleading. It is argued further that certain policies do not serve well the interests of the average consumer. Industry critics are concerned that many consumers do not recognize the advantages and the disadvantages of the products they buy. They argue that certain products lock consumers in, rather than permit flexibility in switching to more suitable policies. Moreover, they contend that many insurance companies continue to concentrate their marketing efforts on products not always best suited to current, consumer protection needs. In general, they question whether the variability and perhaps unsuitability of certain products gives consumers the opportunity to make a reasoned product choice.

As stated, in this Chapter the Committee examines the principal forms of life insurance coverage made available to consumers and some related criticisms under the following headings:

- Permanent Versus Term Coverage
- The Cash Value Benefits of Permanent Insurance



- Options during the Lifetime of the Policyholder
- Settlement Options at Death
- Supplementary Benefits
- Sale of Life Insurance to Non-Breadwinners
- Lapsation
- Replacement of Life Insurance Policies

## **B. PERMANENT VERSUS TERM COVERAGE**

Considerable attention in recent years has been directed to the advantages and disadvantages of permanent forms of life insurance, such as whole life insurance, in comparison to term insurance. Accordingly, the Committee has undertaken a review of the whole life policy and the term policy, which follows.

### **1. The Primary Purpose of Life Insurance**

The primary purpose of life insurance is to provide income protection for dependants and beneficiaries upon the untimely death of the insured. Both permanent and term policies provide this protection. They provide it, however, for different durations of time and under different methods of payment.

Term insurance coverage is for a fixed period of time, providing protection only if the insured dies within the number of years stated in the policy. Permanent insurance provides coverage for as long as the policyholder lives. Whole life insurance is the most common form of “permanent insurance”, but not the only form. Various types of permanent, term and combination policies are available to consumers, as discussed in Chapter 2 and as further illustrated in Table 2 opposite page 12 later in this Chapter.

The nature of the consumer’s life insurance needs determines the type of protection required. Term insurance is often regarded as the best means of satisfying temporary or variable insurance needs at different periods of a consumer’s life cycle. A high amount of term insurance can be purchased in early family years when obligations are high. Lesser amounts of term insurance may be more appropriate in later years when the need for insurance likely reduces. A typical example of reducing insurance needs is that of protection over the period of a mortgage loan.

For most consumers, it appears that the uncertainty of future circumstances makes income protection needs a long-term consideration. Permanent insurance is the only income protection method which provides coverage for family and dependant obligations no matter how long the insured might live. It is intended to provide continuity to insurance coverage to meet the enduring needs of beneficiaries for financial protection.

## **2. The Level Premium Method of Payment**

Because life expectancy decreases as one grows older, the cost charged by insurance companies for death protection also increases with age. When buying term coverage, the policyholder is forced to pay progressively more for insurance with each renewal of coverage. Likewise the premium cost of permanent coverage could be allowed to increase over the lifetime of the policy. However, the insurance industry has developed a method of payment, known as the level premium method, which eases the cost of permanent insurance for risks of older age and permits people to carry life insurance for as long as they live. Fundamental to an understanding of the whole life policy, or any other permanent form of insurance, is a discussion of this method of payment.<sup>1</sup>

A contract of whole life insurance is a product with two integrated characteristics: it provides protection for as long as the policyholder lives and it permits the purchase of this protection for the same dollar amount each year. That is, the payment of whole life insurance premiums are so structured as to remain the same throughout the entire life of the insured rather than go up with age as life expectancy decreases.

The utility of the level premium method of payment is based on the *lifetime of coverage* guaranteed by a whole life policy. Its purpose is to benefit those who wish to maintain coverage in later years but who might be forced to terminate their policies if premiums were to increase with the constant decrease in life expectancy. Level premiums are meant to ensure continuity of coverage. They are not meant to benefit those policyholders who buy insurance for short-term periods of time or those who terminate their whole life policies early.

The level premium method of payment means that, in the early years of the policy, the premiums are much higher than is needed for death protection. In later years, the opposite is true. By this time, part of the premium payments of earlier years will have accumulated in reserves and increased through investment by the life insurance company. This build up of funds lets insurance companies charge a seemingly small premium in later years when life expectancy becomes increasingly shorter.

## **3. Criticisms of a System of Level Premiums and Advice to Buy Term Insurance**

While worthwhile in maintaining the continuity of coverage that is

1. The level premium method of payment is not limited to whole life policies since premiums for many other types of policies, including term, remain the same during the period of coverage. As a consequence, a number of matters concerning the implications of the level premium method of payment have some application to term and other policies, particularly if the period of coverage is relatively long. Traditionally, however, discussions concerning the level premium method of payment have been related to whole life insurance and therefore the comments in this and later sections of this Chapter and throughout the Report have followed this approach.

fundamental to a whole life policy, the level premium system has led to some consumer dissatisfaction on the following grounds. Under a level premium system, consumers often receive a small amount of protection against premature death, relative to the "high" premiums paid in the early years of the policy. Higher levels of death protection can be purchased in early years at the same or lower cost through term insurance. On this basis alone, it is argued that in the early years of raising a family when the needs for insurance are highest, the higher relative cost of whole life insurance may discourage purchase of adequate amounts of insurance. Hence, advice is often given to buy term insurance in order to obtain the most face value of insurance for the premium dollar spent by the policyholder.

The level premium system is also criticized in the longer term. Because it takes funds not needed for death protection in early years away from the consumer, it denies the consumer the ability to place these funds in other investments. It is argued by some that a wise consumer should be able to accumulate enough wealth in an investment funded in early years by the difference in premiums between whole life and term insurance, to pay for the added cost of term insurance in later years. This advice to "buy term and invest the difference" also contends that the wise consumer may have no need for any life insurance *at all* in later life, because sufficient wealth will have been accumulated in a side investment rather than in a whole life policy. These arguments are most persuasive in an inflationary environment where the protective value of permanent insurance is seen to be depreciating.

Furthermore, the advice to "buy term and invest the difference" is often also based on the assumption that life insurance needs will decrease over time, either as a result of fewer family obligations or because other income sources will be sufficient to meet remaining family needs. As a result, continuity of level coverage under a level series of payments may not be appropriate or necessary to consumers in this situation. A typical example of reducing need is that of "mortgage protection", which can be met by decreasing or reducing term insurance, bought on its own or as a rider with a whole life policy.

#### **4. Term Insurance for Long-Term Needs**

Bought on its own, the term policy has the principal advantage that the price per thousand dollars of face amount of coverage is less for term insurance than for whole life. However, at the end of the period of coverage of the term policy, the insured will have to pay a higher premium, appropriate to his then attained age, if he wishes to purchase term coverage again. Meanwhile, the whole life buyer who purchased his original policy at the same time would continue to pay the same or a level premium each year. At some point, the term rates cross over the level premium rates for a



whole life policy. The only way the term insurance buyer can keep his premiums level as he grows older is to reduce the amount of his coverage.

Where insurance needs are likely to be of a long-term or enduring nature, the increasing cost and the potential uninsurability of the consumer must be taken into account. As a result, consideration must be given to the renewability and convertibility of the term policy.

### *Renewable Term*

While short-term protection needs can be met by non-renewable term policies, many term plans give the right to renew for another period, when a term ends. This privilege is available regardless of the state of the insured's health. With each new term, the premium is increased. This kind of insurance is known as level term with increasing premiums. The most common term periods are 5, 10 and 20 years.

Purchase of a renewable term plan requires that consideration be given by the consumer to the increase in premium with each new term. Current rates for renewal need not apply in the future as companies review their pricing policies. Therefore the future cost of renewal is never known with certainty. To overcome this problem, level term with level premiums, known as term-to-65, is also available. The premium cost in early years is, however, higher than that of renewable term.

The uncertainty of future circumstances appears to make protection needs a long-term consideration for most consumers. Therefore, in the extreme, it has been argued that non-renewable term insurance should not be sold. The consumer may be influenced by the lower initial annual premium on non-renewable term insurance to take the chance of being in good health at a later date when evidence of insurability is required for continuing coverage.

Given the importance of the renewability feature, the Committee has attempted to establish, on average, the cost associated with the renewability feature in order to determine what additional cost would be borne by all term policyholders if renewability were made mandatory. The Committee has found that a true cost difference between renewable and non-renewable term cannot be calculated because the policies sold in each category are generally not similar, varying in average face amount of insurance and in underlying pricing factors such as mortality experience. Industry representatives have indicated, however, that they estimate the difference in cost to be about 10 percent.

On the other hand, it has been argued before the Committee that mandatory renewability to age 65 would force persons looking for coverage for a short period of time to pay for a feature they have no intention of exercising. The purchase of life insurance protection for the duration of mort-



gage repayment was offered as an example of a situation in which the policyholder might not wish to purchase the renewability feature.

### *Conversion Privilege*

A further option to be considered by term policyholders is the ability to convert or exchange the term policy for a permanent plan. Usually this option must be exercised a few years before the expiration of the term period. In converting within the prescribed period, the policyholder is not required to give any information about his health. The premium rate charged is based on the current attained age, as if an application for a new policy was being made.

Non-renewable term policies with a conversion feature have been criticized as locking consumers into eventual purchase of a whole life plan. Despite this criticism, the Committee believes that the availability of a conversion option may be appropriate for many consumers as a means toward long-term protection. It may be particularly appropriate for those who cannot afford a permanent plan when they first buy insurance.

The Committee has found that, with some term policies, conversion may be denied if the insured becomes disabled and the waiver of premium rider is invoked. Conversion to whole life during disability would result in the higher premiums on a whole life policy being waived and absorbed by the insurer. From the insured's point of view, however, disability is often a time when a person may wish to exercise the right to convert a term policy to a whole life policy. The disabled policyholder may be ineligible otherwise to obtain a permanent policy or further term coverage if his term policy is non-renewable. Some companies who permit conversion during disability take this factor into account in setting the price for the waiver of premium rider on their term policies.

## **5. The Choice Between Permanent or Temporary Insurance Coverage**

The Committee finds that the choice between permanent and temporary insurance coverage can be a complicated choice for the consumer.

The consumer in purchasing term life insurance must first determine the nature of his needs for income protection, whether they are temporary or permanent. He must as well determine the duration and the amounts of protection required over various periods of time. Thus he must consider what amount of protection he can afford. Finally, he should consider what flexibility is available to him through options to increase or renew coverage if his circumstances change. It is important in the Committee's view that these four considerations be brought to his attention by the marketers of life insurance. The consumer will then be in a better position to deter-

mine what type of insurance he requires, what options are necessary or whether he should choose term insurance or favour a permanent plan.

## 6. Trends in the Purchase of Permanent Versus Term Types of Policies

It appears today that people are buying more term insurance than whole life insurance. New business written in 1978 in Canada indicated that 65 percent of the face amount of new policies were term insurance, including temporary term additions to existing contracts. By comparison in 1970, term insurance and term additions accounted for 55 percent of individual life insurance purchases by amount.

The following table shows the growth trend in sales of term insurance policies over the 1973 to 1978 period for 29 companies doing business in Canada and reporting to LIMRA in "The 1978 Buyer Study (Canada)".

TABLE 1  
TREND IN TERM VOLUME, 1973-1978  
(sample of 29 companies doing business in Canada)

Types of Term Policies	Percent of all Agents' Total Volume					
	1973	1974	1975	1976	1977	1978
Level and decreasing term policies	33%	34%	38%	39%	42%	44%
Term coverage in family plan policies	4	3	3	3	1	2
Term coverage in other combination policies	10	11	11	12	12	12
Total	47%	48%	52%	54%	55%	58%

Source: LIMRA, The 1978 Buyer Study (Canada).

No data are available to indicate the extent to which term plans are renewable or convertible. A more detailed overview of the distribution of sales by product type is provided in Table 2. Indicated as well in Table 2 are some of the variations in permanent, term and combination policies available to consumers.

LIMRA comments as follows on the trend to term insurance: "the marketing of term insurance appears to be so firmly established that it is now questionable whether even a strong economic recovery will significantly reverse the trend".<sup>1</sup> The plans most affected by the shift to term, as identified by LIMRA, are the endowment and whole life retirement policies in the male market and the whole life, limited payment plans in the female segment. LIMRA attributes the shift in product mix to inflationary

1. LIMRA, The 1977 Buyer Study (Canada).

TABLE 2

## ORDINARY-AGENT SALES - THE 1978 BUYER STUDY: CANADA

TYPE OF POLICY		% of Policies	% of Premiums	% of Volume	Average Size Policy	Premium Per Policy	Premium Per \$1,000
MALE ADULT LIVES							
Permanent							
1. Whole life - continuous pay		34%	37%	20%	\$22,120	\$419	\$19.00
2. Whole life - limited pay		7	5	3	15,020	286	18.70
3. Endowment		3	4	1	15,310	443	28.90
4. Retirement income		4	6	2	16,140	638	39.50
5. Modified life		3	5	4	37,030	527	13.50
Term							
7. Level term		24	22	42	68,040	352	5.20
8. Decreasing term		7	4	9	48,170	210	4.40
Combination							
9. Whole life - continuous pay with term riders		8	9	11	52,020	415	8.00
10. Family plan		2	1	1	30,370	303	10.00
11. Family plan with additional term		1	1	1	(47,740)	(364)	(7.60)
12. Extra protection		2	1	1	22,770	240	10.50
13. Other policies with term*		5	5	5	42,230	360	8.50
		100%	100%	100%	\$38,340	\$382	\$10.00

# FEMALE ADULT LIVES

## TYPE OF POLICY

### Permanent

1. Whole life - continuous pay	43%	40%	27%	\$11,330	\$201	\$17.70
2. Whole life - limited pay	12	11	6	9,680	195	20.10
3. Endowment	5	8	4	12,610	349	27.70
4. Retirement income	4	10	3	13,670	580	42.40
5. Modified life	3	3	3	21,220	259	12.20

### Term

6. Level term	13	11	28	39,200	175	4.50
7. Decreasing term	5	3	9	33,160	126	3.80

### Combination

8. Whole life - continuous pay with term riders	6	6	11	36,500	241	6.60
9. Family plan	1	1	1	21,940	159	7.30
10. Family plan with additional term	**	**	**	***	***	***
11. Extra protection	5	3	3	11,770	139	11.80
12. Other policies with term*	3	4	5	28,170	233	8.30
	100%	100%	100%	\$18,410	\$215	\$11.70

\* Coverages containing permanent and term not elsewhere classified.  
 \*\* Less than ½ of 1 percent  
 \*\*\* Fewer than 10 cases  
 ( ) Based on 10 to 25 cases

Source: LIMRA, The 1978 Buyer Study (Canada).



conditions affecting spending decisions and the competition of Registered Retirement Savings Plans for long-term savings funds.

LIMRA also states that the erosion of the market share of permanent insurance is largely tied into the depreciating protective value and cash value of such policies. In terms of protection value, consumers are finding they can buy, at least in earlier years, a greater face amount of protection through term insurance than through whole life insurance. Inflation has made it increasingly necessary to consider purchase of large amounts of death protection, especially in early family years.

## **C. THE CASH VALUE BENEFITS OF PERMANENT INSURANCE**

Discussion now turns to the permanent life insurance contract, with specific attention on the cash value benefits available to consumers with permanent forms of insurance.<sup>1</sup>

### **1. The Development of Cash Value Benefits**

The Committee finds that a historical perspective on the development of cash value benefits in a permanent life insurance policy is necessary to a proper understanding of the permanent life insurance product and its value to the consumer.

The earlier discussion of the level premium method of payment indicated that, in early years, the level premiums paid for whole life policies are much higher than is needed for death protection. By this time, part of the premium contributions of earlier years will have accumulated in reserves and increased through investment by the life insurance company. The funds accumulating in reserves reduce the amount of the face value of the policy that must be paid at death out of the general pool of insurance funds.

The whole life, level premium contributions that accumulate in reserves represent premiums under a contract which promises to pay benefits upon the death of the insured. The insured has no ownership interest in the contributions he has made to the policy reserves. By paying premiums he acquires instead a "bundle of benefits" which are the only property available to him under the insurance contract. The primary benefit in this "bundle" is life insurance protection.

When the whole life policy was first developed, the level premium contributions accumulating in reserves entitled the policyholder solely to benefits to be paid at death. However, even in the earliest policies issued in Can-

1. As indicated in the footnote on page 4, some matters related to the level premium method of payment have some application to term and other policies, particularly if the period of the coverage is relatively long. One of these matters concerns cash value benefits which are provided by some companies as ancillary benefits with their term policies and possibly could be provided by all companies. For purposes of this Report, however, comments concerning cash value benefits have been confined to the more traditional discussions as they relate to whole life and endowment policies.

ada in the 1850's, additional benefits began to be attributed to the premium funds held by insurers. Some companies agreed to pay, as a benefit whenever the person wished to surrender his policy, an amount out of the reserves subject to a deduction for the value of insurance "used up" while the policy was in force.

Both in Canada and in the United States it became apparent that many insurance companies were profiting handsomely from the premiums they held for long periods. Except in the case of a few companies, these premiums were "forfeited" or lost to insureds who lapsed or cancelled their whole life policies.

Part of the thrust for recognizing that benefits other than death protection should be attached to a level premium whole life policy came from the courts and from regulators in the United States. Two developments were of particular importance in this regard. The first was a landmark decision of the Supreme Court of the United States in the 1870's which ruled that a policyholder has an "equitable right" to the premiums held in reserves: "Subject to a deduction for the value of the assurance enjoyed by him whilst the policy was in existence . . . he is fairly entitled to have the equitable value of his policy".<sup>1</sup> The second development was the emergence of a crusading life insurance reformer, Elizur Wright. Wright's efforts at insurance reform spanned 40 years. While he was Commissioner of Insurance in Massachusetts he was instrumental in 1861 in obtaining a non-forfeiture law providing a policyholder with single-premium extended term insurance. Later several companies offered paid-up insurance as a further non-forfeiture feature. In 1880, Massachusetts enacted a third non-forfeiture alternative which required payment of value in cash upon surrender of a life insurance policy.

Through further regulation in the United States and through imitation and force of competition in Canada, it became necessary for all life insurers to give something back to a policyholder who gives up his whole life policy. The amount to be returned to the policyholder was termed the policy's "cash value".

The basis for a policy's cash value was the level premiums accumulating in reserves. The cash value for a whole life policy was increased each year at a rate specified in the contract, based on the excess premium payments for that year and the interest credited to the cash value that had been previously accumulated. The interest credited to the cash value became non-taxable during the accumulation period.

With the advent of the concept of cash value, a number of ancillary benefits or rights were attributed to the whole life contract. Today, cash values not only are paid to the policyholder upon the surrender of a life insurance policy but also are the means by which equivalent insurance benefits

1. *New York Life Insurance Company versus Statham*, 93 U.S. 789 (1876).

such as a single-premium purchase of extended term insurance or paid-up whole life insurance are funded. Other examples of the benefits arising out of cash values include their use as collateral for a low cost policy loan and for automatic loans to keep the policy in force if premiums are missed. More detailed consideration of these ancillary benefit options is undertaken later in this chapter.

The benefits or rights associated with the cash value of a policy are not, however, added to the rights for payment of death benefits. A policyholder cannot have both cash value benefits and insurance benefits. By taking cash value benefits, the policyholder reduces or cancels the promise to pay death benefits. To maintain the full amount of his insurance coverage intact he must leave the cash value in his policy. As a result, the cash value feature of life insurance becomes “incidental” to the real purpose of whole life insurance, that being death protection.

The Committee finds nonetheless that the availability of a cash value and ancillary benefits provides a needed flexibility to policyholders who, through changing circumstances, may realize that the whole life policy they bought years ago no longer suits their current protection needs. These policyholders are able to give up their whole life policy and get back some part of their premium contributions in benefits or in cash.

## **2. Whole Life Insurance as Savings**

The Committee believes that the development of an ancillary benefit called “cash value” may, over time, have resulted in a dual purpose to the whole life policy in the minds of consumers. While the Committee believes that consumers continue to buy life insurance primarily for death protection, it appears that, once bought, the whole life policy is often seen to be versatile in terms of providing income benefits *either at death or at some future point in the policyholder's lifetime*.

Because the whole life contract provides ancillary rights to the insured during his lifetime, the policyholder is able to change his mind about the original purpose for which he bought level premium insurance. In other words he can use his whole life policy in the way term insurance is used. Should his insurance needs reduce over time, he can reduce the amount of his permanent insurance coverage and draw upon the cash value in his policy as a form of “savings”, accessible to him through loans or policy surrender. While the contract of insurance does not entitle him to “savings” in the manner of bank deposits, in practice the policyholder is able to use the accumulated reserve in his policy for either savings or insurance.

The view that whole life policies are separable into an insurance component and an investment or savings component has a history as long as that of cash values. In 1876 in the United States, a Supreme Court decision described the reserve fund growing out of premium payments:



“somewhat as a deposit in a savings bank is said to belong to the person who makes the deposit.”<sup>1</sup>

This statement merely established an analogy relating reserves to a fund of personal savings; it did not establish an ownership right in a reserve fund with the right of withdrawal as is the case for bank deposits. Nevertheless, it led the way to more than a century of controversy over the true significance of cash values.

The duality of purpose that appears to have arisen in respect to whole life policies leads, however, to dissatisfaction on at least three grounds:

- The duality of purpose in the whole life policy may confuse the purchase decision for the consumer. It may detract from the primary considerations of continuity of death protection coverage, sufficient amounts of insurance coverage and the over-a-lifetime costs of such coverage.
- Should the policyholder be unhappy with the benefits in his policy, he may lose substantial amounts of money through termination of level premium policies in the first years of coverage. This occurs because cash values build up very slowly during the early years of the policy. As a result, policyowners may feel “locked in” to what they may consider to be a poor choice of protection and savings—despite the promise of flexibility provided by the cash value feature of whole life policies.
- When the difference between the cost of purchasing death protection and the level premium paid is seen as a form of “savings”, it may be found, especially in an inflationary environment, that the rate of build-up of cash values falls behind the current rate of return on other forms of savings and investment.

### 3. The Endowment Policy

Unlike the whole life policy, the endowment policy is a contract designed with *specific emphasis on savings* in combination with life insurance protection. It pays a fixed sum at the end of a specified period if the policyholder is still living or on the previous death of the life insured.

That is, the endowment policy provides life insurance protection for specified periods of time, such as 10, 15, or 20 years or up to retirement age such as 65 or 70. In this sense, it is not unlike a term policy. However, endowment insurance provides for level premium amounts payable until the end of the period of until prior death.

The endowment policy is typically intended for people who wish to have a planned system of savings but at the same time need life insurance protection in the event they do not reach the age at which they had planned to take out and use their savings. As such, endowment insurance serves the

1. *New York Life Insurance Company versus Statham*, 93 U.S. 789 (1876).



purpose of combining the needs for insurance with the needs for savings, a purpose not intended with whole life insurance.

As with whole life insurance, the level premium method of payment permits the build up of cash values. However, the nature of the endowment policy is such that it is intended for fixed term savings; early withdrawal of cash value in the manner of withdrawal of savings deposits is not intended by the structure of the endowment contract.

“Buying term and investing the difference” may be an alternative choice to the purchase of an endowment policy, as it may be to the purchase of whole life insurance. In fact it approximates endowment insurance more closely than whole life insurance because of the fixed term nature of the endowment contract. The consumer’s choice of endowment insurance likely is determined by his need for planned or “fixed term” savings rather than voluntary savings through other financial institutions.

#### **4. The Marketing of Whole Life Policies**

In the past, the insurance industry has marketed whole life and endowment insurance products, stressing the advantages of the cash value feature in addition to the primary purpose of death protection. Recognition of cash value is inherent, for example, in the industry’s reference to permanent insurance as “forced savings”. It is evident as well in the sale of permanent insurance policies for retirement income purposes or for an educational fund for children. It is furthermore apparent in the description of the whole life policy as a versatile financial instrument providing features not available through term insurance.

The life insurance industry in recent years has reversed its approach to the whole life policy and now regards it as an inseparable whole, providing continuing death protection under a level premium system of payment. Cash value is regarded as an incidental by-product. While the industry acknowledges that its past emphasis on cash value was a mistake, some whole life and endowment insurance policies continue to be sold as retirement savings vehicles or as “forced savings” funds for future spending purposes as well as permanent insurance protection.

Critics of the life insurance industry contend that, as a result, too much whole life insurance is held by the public. They also attribute this situation to sales pressure behind whole life and to larger commissions paid to the insurance agent on whole life policies. The Committee comments on commissions payable by type of policy in a later chapter of this Report.

#### **D. OPTIONS OVER THE LIFETIME OF THE POLICY**

It is evident from the previous discussion of cash value policies that the consumer is faced with a number of ancillary benefit options related to the

whole life insurance policy he is buying. The ability of the insured to purchase with his individual needs in mind is related to his knowledge of what ancillary options are made available in areas such as:

- non-payment and surrender options, and
- policy loan options.

These subjects are reviewed in turn in this section. The options mentioned here are related to the cash value in a whole life policy; they make the whole life policy a so-called “versatile financial instrument” which provides features not available to the purchaser of term insurance. However, it is noted by some commentators on life insurance that these options may be approximated by use of funds saved as a result of buying lower cost term insurance in earlier years.

A further topic to be covered in this section, in relation to surrender options, is that of the amount of cash value made available to a policyholder, both in a traditional whole life policy and in the case of so-called “new money policies”.

### **1. Non-payment and Surrender Options**

If the premium is not paid when due, The Insurance Act provides for a grace period of thirty days during which the policy stays in force. The Act also stipulates the conditions upon which a policy may be reinstated, if lapsed.

In addition to these requirements, if a policyholder wishes to discontinue his policy or omits to pay a premium or premiums as due, the earlier discussion on cash values indicated that life insurance companies protect the insured from complete forfeiture or loss of premiums paid in previous periods on cash value policies. Canadian companies voluntarily provide for payment of “non-forfeiture” benefits as there is no legal requirement in Ontario or in other provinces for the payment of such benefits. In contrast, in the United States, virtually all states have adopted standard non-forfeiture laws that provide minimum requirements for payment of non-forfeiture benefits.

All Canadian companies voluntarily grant non-forfeiture benefits in their cash value life insurance policies, generally but not necessarily in these four forms:

1. The payment of cash value accumulated in the policy. Some companies may defer payment of cash amounts for 30 or 90 days after policy surrender.
2. The conversion of the policy for a fully paid-up policy for a smaller amount than the original policy. Usually the paid-up policy is of the same type as the original policy although some companies stipulate other options such as paid-up endowment insurance.

3. The continuation or extension of the policy, for the face amount less any indebtedness, as term insurance for a fixed period of time. All supplementary benefits such as riders are terminated.
4. The automatic payment of premiums through a policy loan.

These privileges are not available on term insurance. A consumer must elect one of the first three options, otherwise the fourth is normally applied automatically.

The Insurance Act, while not specifying any options, requires that the options, if any, on surrendering the contract be set out in the policy. That is, the Insurance Act in Ontario provides that the insurer set out in the policy:

- 149(2) 2. “The amount, or the method of determining the amount, of the insurance money payable, and the conditions under which it becomes payable”.
- 149(2) 6. “The options, if any,
  - (a) of surrendering the contract for cash;
  - (b) of obtaining a loan or an advance payment of the insurance money; and
  - (c) of obtaining paid-up or extended insurance”.

Observations on cash surrender values and new money policies follow.

## **2. Determination of the Amount of Cash Surrender Value**

An amount to be returned on surrender of the life insurance policy is in most cases guaranteed by life insurance companies in Canada although there is no requirement in law to do so as there is in the United States.

Determination of the cash amount available on surrender of a policy is based on the cash value as described earlier in this chapter. The cash values guaranteed under the policy build up slowly in early years and equal the policy reserves usually only after 15 or 20 years. In the intervening periods, the determination of cash surrender values is dependent on a variety of factors including investment guarantees and the allocation of the high first year costs related to the sale and issue of a policy.

In the United States, “standard valuation laws” have provided for methods of calculating minimum guarantees<sup>1</sup> of cash surrender value, as required by “non-forfeiture laws”. The practice in Canada is for each company to establish its own guarantee for cash value, with the general method to be outlined in the policy contract. No uniform or minimum standards exist for such calculations as in the United States nor is there any require-

1. The method of calculating minimum values under the standard valuation laws accommodates the expense rates incurred by marginal or high-cost companies. In so doing, it may well result in a lower cash value than might otherwise be the case for more efficient companies.

ment as to the policy year in which the guarantee of cash surrender value should start. Guaranteed cash surrender values are generally provided at the second policy year and thereafter and on certain policies at the end of the first policy year. The CLIA has established guidelines for calculation of surrender values between policy anniversary dates.

An illustration of the amount of the guaranteed cash surrender values, paid-up insurance amounts and sometimes extended values is typically provided to the policyholder with his contract. There is however no requirement in law for this form of disclosure. The Superintendent of Insurance in his submission has recommended to the Committee that:

“Disclosure of all cash, paid-up or extended values should be required to be included in policies in pertinent tables for the first twenty years and at age 55, 60 or 65 wherever applicable.”

In the United Kingdom, the law and practice differ from that in North America. As in Canada there are no requirements in law that cash surrender values be paid and hence no requirements for standard calculation of minimum cash values. Unlike in Canada, in practice most companies decline to guarantee cash surrender values, although they are paid but on a non-guaranteed basis. That is, companies selling in the United Kingdom prefer to vary cash values in accordance with changes in investment conditions. They normally provide their policyholders with an illustration of non-guaranteed surrender values.

### *Observations*

The Committee sees at present no compelling need in this Province to require by non-forfeiture and valuation laws that insurers guarantee certain minimum cash surrender values and cash value options. The Committee finds, however, that guarantees of cash value differ among companies, even on similar policies, with implications for the cost of insurance. The Committee comments further on the significance of cash surrender values on the cost of insurance in Chapter 9 of this Report.

## **3. “Adjustable Benefit” or “New Money” Policies**

### *The Concept of Adjustable Benefit Policies*

Certain whole life policies sold in Canada based on prevailing or so-called “new money” rates of return follow the U.K. practice in that they do not guarantee surrender values. They differ further from typical products in Canada or the United Kingdom in that they also do not guarantee face amounts of the policy, hence the term “adjustable” or “adjustable benefit” policies. Such policies have only recently been introduced and are available from only two or three companies; yet they appear to be attractive in today’s inflationary economic climate. However, they present consumers with the



problem of understanding what value would be received upon death or upon surrender or lapse of such policies. A further description follows.

As previously discussed, it is the usual practice that, in issuing a life insurance contract, a life company makes long-term guarantees to the policyholder. In making this guarantee the company must carefully examine interest rates, mortality experience and expenses over the length of the contract. Of these three factors, interest rates are the most difficult to project into the future. As a result, life insurers make conservative interest rate assumptions, especially on permanent policies.

New money adjustable products also offer long-term guarantees to the policyowner but in a very different manner. The term "new money" refers to the higher interest rates which have become commonplace in the past fifteen years. New money adjustable contracts are usually less expensive than traditional contracts because the company assumes that interest rates will continue at approximately current levels for the lifetime of the contract. New money contracts also are based upon the assumption that mortality experience and company expenses will remain relatively constant, these factors generally being less subject to change than interest rates.

New money adjustable products are renewed and possibly adjusted at designated intervals—every five, or for some products, every ten years. If the outlook is for increased interest rates, or if the mortality or expense outlook is more favourable than anticipated, the face amount of the policy is increased at no additional cost to the policyowner. Similarly, if interest rates have dropped significantly, the face amount of the policy may be adjusted downwards, the extent of adjustment varying typically with the age at entry. Even in this event, the policyowner is typically protected by these contractual guarantees:

1. The policyowner may retain the original face amount of the policy without medical evidence by paying an additional premium.
2. Each policy contains a guaranteed minimum death benefit beyond which no adjustment can be made.

In some policies offered in the U.S., the policy guarantees as a minimum a stated period and amount of term insurance.

In effect, new money pricing allows the insurer to overcome many of the difficulties with the conservative long-term assumptions associated with the traditional pricing of life insurance. These products allow the policyowner to participate in the investment risk in return for a significantly reduced "up-front" insurance cost. The major benefits of new money pricing over traditional pricing from the policyowner's point of view is that it allows him to benefit immediately from favourable conditions rather than having to wait for many years into the contract as is the case in more standard forms of participating insurance.

The funding of a “new money” policy may be in the form of a single up-front premium rather than monthly or annual premiums. The payment of a single premium results in very high early cash values.

The high early cash values have a practical benefit at the time of original purchase. Many people do not have the amount of money required to pay a single lifetime premium but the existence of high cash values allows a potential policyowner to borrow the funds either from the company or a bank. The cash values guaranteed in the policy are held as security against the loan and the policyowner can arrange a repayment schedule which suits his individual circumstances.

### *Guidelines for Illustration of Non-Guaranteed Benefits*

The CLIA has recognized the necessity of establishing guidelines for the illustration of non-guaranteed benefits including those provided in a new money policy. There is however no legal requirement that such illustrations be made available to the policyholder.

There is as well no standard in law for a minimum guaranteed face amount to be paid in death benefits as a claim on a new money policy. As these policies are new, and current investment conditions are pushing face amounts of new money policies above illustrated values, it may be difficult for consumers to evaluate whether the minimum amounts of insurance guaranteed under new money contracts are appropriate for the amount of premium collected and appropriate vis-a-vis other life insurance products on the market.

### *Observations*

It would therefore seem appropriate to the Committee that, in marketing these policies, applications, policy literature and contract forms clearly indicate that, if interest rates drop significantly from the levels current when the policy is purchased, the face amount of the policy may *be adjusted downwards*. From a sales point of view, insurers are likely to indicate the potential for upward adjustment. The minimum death benefit beyond which no adjustment downwards can be made should also be clearly indicated to alert consumers to the extent of adjustment that is possible.

As it is possible to maintain the original face amount of the policy without medical evidence by paying an additional premium, the new money policy can become a vehicle for selling additional insurance under the current contract, without the necessity of buying a new policy. It is the Committee’s view that the consumer should be made aware, in broad terms, of the additional premiums that would be required to maintain coverage.

Furthermore, it is the Committee’s view that the new money policy requires greater ongoing service, both to report changes in face amount and

non-forfeiture values and to counsel policyholders should adjustments be needed in their policies. In general it requires greater information on policy specification and a special display of cash and non-forfeiture values.

#### 4. Policy Loan Options

##### *Automatic Policy Loan*

As earlier mentioned, it is the general although not universal practice of life insurers in Canada to apply a policy loan automatically if premiums remain unpaid at the end of the days of grace and if other non-forfeiture options are not elected. An automatic premium loan keeps the policy and riders fully in force until the cash value is used up through extended non-payment of premiums and application of interest on the loan.

##### *Personal Loan Option*

A significant feature of all cash value policies is the collateral they provide for a personal loan. This loan can be made from a life insurance company, or the collateral can be assigned to a lending institution with which the loan is made. An advantage of a policy loan through a life insurer is the informality of the application process.

The amount of policy loans represents only one percent of the amount of business in force in individual life insurance policies, which provide death benefits. However, in terms of assets, policy loans in 1978 accounted for 4.3% of the total assets of life insurance companies.

The part played by life insurance companies in providing funds to Canadians for purposes of personal loans is shown in the table below. Personal loans outstanding with life insurance companies accounted for about five percent of total loans outstanding in Canada with six major financial institutions.

TABLE 3  
PERSONAL LOANS OUTSTANDING IN CANADA  
(Last Quarter 1978)

	\$ Million	Percent
Chartered Banks	\$20,967.8	68.9%
Local Credit Unions	5,490.2	18.0
Financial Corporations <sup>1</sup>	1,736.4	5.7
Life Insurance Companies	1,455.9	4.8
Trust and Mortgage Companies	649.7	2.1
Quebec Savings Banks	139.1	0.5
	\$30,439.1	100.0

1. Acceptance and Consumer Loan Companies

Source: Statistics Canada

Generally life insurers discourage policy loans as smaller loan amounts make servicing of the loan costly and because a loan often results in termination of the policy. Some companies defer cash loans for up to 6 months after applications; others may have no restriction.

Although a policy loan is termed a "loan" it is merely a deduction from the sum the insurer ultimately must pay in benefits. It is more properly termed an *advance*. As a result a policy loan does not create an ordinary debtor-creditor relationship but rather it is the exercise of an ancillary right under the contract. Because it is an advance the insurer cannot demand repayment.

Because the policy loan is an advance, when a policyholder borrows against the cash value of a policy, he must take into account that the amount payable to beneficiaries will be reduced accordingly. That is, if a policyholder borrows against the cash value and dies before the loan is repaid, the amount outstanding plus interest is subtracted from the policy's face amount before payment is made to beneficiaries. Similarly, if the policyholder cancels his or her policy, the cash value of the policy less outstanding loans and interest is payable to the policyholder. A further consideration is that a portion of the loan related to investment of the policy proceeds is taxable as income to the policyholder.<sup>1</sup> It is the Committee's view that these factors should be brought to the consumer's attention in evaluating the loan feature of the whole life policy, particularly when consideration might be given to other methods of obtaining funds in the future.

A second consideration is the amount of interest payable on the loan. If the interest is not paid, it is added to the loan. If the unpaid interest added to the loan becomes larger than the cash value, the policy will be terminated without value. Normally the loan and interest can be repaid at the policyholder's choice.

In most U.S. jurisdictions, the amount of interest payable on a loan is regulated. At the present time in Canada, since about 1968, companies omit mention of a guaranteed maximum rate of interest although they did so for many years in the past, when interest rates were more stable. It is now the practice to specify a maximum rate in the loan agreement if no maximum is stated in the policy. Rates charged and specified maximums can vary from very generous to equal to or above the bank lending rate.<sup>2</sup>

As general interest rates have climbed in recent months, member companies of the CLIA have worked out a proposal in consultation with the federal Department of Insurance, to introduce a flexible maximum interest rate on policy loans. It is proposed that the maximum policy loan rate would be related to a general interest rate indicator; that it could be revised periodically; but that it would be lower than that applied to a well-secured consumer

1. *Globe and Mail*, "Loan on a life policy will be subject to tax", November 1979.

2. *Ibid*.



loan. Guidelines would require companies to state in the loan agreement what the maximum rate would be, how it would be revised and how often it would be subject to revision, say monthly or annually.

Insurers state that with the recent rapid rise in interest rates, they expect policy loans to increase substantially. Sharp rises in policy loan activity were already reported in the third quarter of 1979.<sup>1</sup>

## E. SETTLEMENT OPTIONS AT DEATH

Benefits are paid under a life insurance policy to beneficiaries upon death and to the policyholder if an endowment policy matures or if a policy with cash value is surrendered. This section is concerned primarily with a review of the settlement options upon death of the insured.

Various options for settlement at death can be selected at the time the policy is issued, over the lifetime of the policy or by the beneficiary when the policy becomes payable. If an option is selected by the insured, sometimes the beneficiary may not be able to make a change.

Four basic settlement options are most commonly used:

- The money can be taken in a single or lump sum.
- The money can be left with the insurer for later withdrawal, while interest is paid out periodically.
- The money can be received in fixed instalments. Interest is added to the unpaid balance at a guaranteed rate. A right of withdrawal is normally provided. Instalments can be arranged by length of time (period certain) or by amount.
- The money can be converted to a life annuity or a guaranteed term life annuity.

Special options are also available from some companies. It is noteworthy that some 95% of death benefit payments continue as lump sum payments.

Some considerations in deciding upon the choice of settlement option include:

- Consideration should be given to the interest rate paid by the insurance company on money left with it. Guaranteed rates may be low, such as 2.5% to 3.5%, however, excess interest which is not guaranteed may be paid each year. Both rates might be compared to the prevailing rate on investments or bank deposits.
- Selection of a particular settlement plan by the policyholder might cause serious problems for beneficiaries. Hence, settlement options should be reviewed periodically or be non-binding.

1. *Globe and Mail*, "Insurers preparing guidelines for policy interest rates", March 20, 1980.

- Each company determines the type of instalment and annuity options to be made available on settlement. Some companies offer annuities at rates slightly below their normal rates.
- Consideration should be given to the adequacy of monthly or annual payments in meeting the beneficiaries' current needs. An early review of the income scheme might encourage purchase of a higher level of coverage.
- Instalment options should be reviewed as to whether a definite period or definite amount is more suitable to the beneficiaries' circumstances. In a life annuity option, it might be noted that different amounts apply to male and female lives. In an immediate annuity, the year or day of purchase may affect the income stream available to beneficiaries.
- Instalment payments are often quoted in monthly amounts. Conversion to less frequent payments may involve a penalty in some companies, no penalty in others and a bonus in some.
- As no charge is made by the insurance companies for the use of a settlement option, some insurers may discourage the tying up of small policies under settlement options or may require minimum payments to avoid the burden of small payments. Also insurance companies may be reluctant to undertake the cost of satisfying trust conditions before paying an instalment under a settlement option. Problems sometimes arise, for example, in remarriage situations.

### *Observations*

Settlement options are essential considerations in the planning of income protection, but may be an area which receives little consideration by the policyholder. In some cases an option may be chosen by the insured which is never again reviewed and which inflicts hardship on the beneficiary at a later point in time. The Committee stresses the importance of improved information about these options at the point of sale and on an ongoing basis, as circumstances change.

## **F. SUPPLEMENTARY BENEFITS**

### **1. Common Riders**

In purchasing a life insurance policy, supplementary or optional benefits can be attached to the policy in the form of riders or options. The most common types of riders or options are:

- Waiver of premium, which provides the policy will be kept in force if the insured or payor becomes disabled;
- Disability income, which provides a limited monthly income to the in-

sured in the event of disability; this rider is often combined with the waiver of premium;

- Accidental death benefit, which provides that additional amounts of insurance, frequently twice (double indemnity) the face amount of the policy will be paid if the insured dies in an accident;
- Guaranteed insurability or guaranteed policy option, which gives the option to buy a stated amount of additional insurance at specific intervals, without evidence of insurability.

Numerous other plan options also termed as “riders” are available, such as level term riders, cost of living riders, and family plan options. Detailed discussion of such supplementary or customized benefits has not been attempted in this Report.

The value of riders to individual purchasers of life insurance varies in accordance with individual needs. A review of the major features of the most common riders, followed by concerns brought forth before the Committee, is presented in this section.

## **2. Waiver of Premium**

The waiver of premium clause, available in most policies, frees the policyholder from any obligation to pay premiums on a policy if he or she becomes totally disabled through accident or sickness. Usually there is provision for a six month period of disability before the waiver of premium comes into effect, although often the provision is retroactive to the beginning of the disability. In most policies, disability must commence before age 60 for qualification under the waiver of premium clause.

The extra cost of this waiver may be built into the basic insurance premium. In such a case, the consumer is prevented from comparative price shopping for the waiver as a policy option.

There can be considerable variation among companies in the application of and definitions related to the waiver of premium clause. Important variations can be related to:

- the definition of “total” disability,
- the age requirement for eligibility,
- the age, usually 65, at which the waiver claim ceases to apply altogether, and
- the waiting period before the rider takes effect.

A special provision is said to exist in some policies allowing reinstatement within one year after policy lapse with proof of disability at the time when the policy terminates. Normal reinstatement provisions require that medical evidence of insurability be obtained. As a disabled person may not qualify for reinstatement under normal provisions, this special provision is

to his benefit, although reinstatement will cause the suicide and incontestability provisions to start anew. The Committee finds this provision to be a beneficial practice on the part of some insurance companies.

### *Underwriting and Availability*

The waiver of premium rider is typically underwritten separately from the life insurance policy. With minor exceptions, it would be made available at standard rates to applicants rated as standard for the basic policy. It would be denied or rated above standard for high risk policyholders. In some cases, this rider is not sold to policyholders past a certain age, such as 55. Morbidity experience statistics used to rate the waiver of premium rider are "contaminated" by a lack of a common definition of total disability. As a result, many actuaries prefer to use their individual company's experience, perhaps modified by waiver of premiums statistics put out periodically by the Society of Actuaries.

When the insured is not the premium payor, as sometimes in the case of an insured homemaker spouse or child, the waiver of premium rider applies to the payor and may be rated on the basis of the health and other rating characteristics of the payor. In this case, disability of the payor invokes the benefits of the rider, whereas disability of the insured does not.

The availability of the waiver of premium benefit on the lives of housewives or homemaker spouses in general is a matter which has been brought to the Committee's attention. The Committee has learned that the results of a CLIA survey of underwriting practices undertaken in 1977 indicates that about 71 of the 81 companies providing information on this subject said that they did offer the benefit to women whose sole occupation was that of housewife at the time of application.

Noteworthy, also, is the fact that, in the past, women were considered to be worse risks where sickness and disability are concerned. It is still sometimes the practice to grant this rider to self-supporting, single women at the same or 1½ times the rate for males.

### *Waiver and Disability Income Combinations*

The waiver of premium may be sold alone or combined with a number of other provisions such as:

- waiver of premium and sum insured payable in instalments,
- waiver of premium and disability annuity without reduction in sum insured, and
- waiver of premium and temporary disability annuity followed by payment of sum insured.

Eighty-five percent of waivers insured in Canada in 1977 were a waiver



of premium only and just over 10 percent provided for a waiver of premiums and sum insured payable in instalments; less than 5 percent of waivers insured included a disability annuity. The majority of riders paying the sum insured in instalments were related to group contracts. With payment of the sum insured as a provision, the life insurance contract is terminated after a fixed period of time.

### *Premiums and Claims*

Total premium income for the waiver of premiums rider amounted to \$31.8 million in 1978 in Canada.

Premiums waived in 1978 for both ordinary and group policies amounted to \$6.4 million. These amounts are not, however, related to the premium income received in that year.

The premiums waived for ordinary and group policies are not identified separately in available statistics. However, the Federal Superintendent's Annual Report shows that, of the 81,105 policies on which premiums were waived in 1978, 42 percent were related to individual contracts.

### *Definition of "Total Disability"*

The definition of "total disability" varies somewhat from company to company, but the definitions, in general, fall into three categories. In the order of less liberal to more liberal definitions, they are:

- Total disability is the complete inability to engage in any work or occupation for remuneration or profit;
- Total disability is the complete inability to engage in any gainful occupation for which one is reasonably fitted by education, training, or experience; and
- Total disability is the complete inability to engage in one's regular occupation, provided that typically after 24 months of such disability, it is the complete inability to engage in any gainful occupation for which one is reasonably fitted by education, training, or experience.

Sometimes the definition states that total blindness or the loss of two hands or feet, or of one hand and one foot, will also constitute total disability regardless of whether or not the individual can work. Some companies indicate that total disability could be bodily or mental in nature.

As stated, the definitions of total and permanent disability are not consistent among companies. In practice however, companies tend to be relatively flexible in applying the definitions, particularly in respect to benefits limited to the waiver of premium.

The applicability of the disability definitions might be noted in the case of unemployed persons and homemaker spouses. For example, an individ-

ual who is unemployed would be judged according to the definitions of total disability as above. If the definition in his contract were of the type as in the third definition above, some regular occupation, perhaps the last one prior to unemployment, would be attributed to the individual.

With respect to the claims of housewives under a waiver of premium benefits, an individual whose occupation is that of a housewife would be judged as any other individual having an occupation according to the definition of total disability in use at that company. At least one company, however, has a separate definition of total disability for an individual whose occupation is that of a housewife—namely the incapacity to engage in that occupation. This corresponds to the third definition above except that there is no 24 month limitation on the regular occupation.

### *Provisions Related to Disability*

While the waiver of premium rider available in most policies will free the policyholder from any obligation to pay premiums, it may not apply when:

- disability is not “total”,
- disability does not continue past 6 months,
- disability occurs at or past age 60 or 65,
- illness or injury is sustained through age 65 or over.

In these cases, if the policyholder does not pay his premiums, his policy will lapse. With a whole life policy his coverage remains in force under an automatic policy loan but, with such, the insured loses some part of the value of his surrender and death benefits. The subject of definition of total disability was discussed above; the latter three factors are considered below.

Proof that the insured has been disabled for at least six months before he is eligible for waiver of premium coverage is required to ensure that disability is in fact established. As for disability occurring at advanced ages, the limiting age of 60 or 65 is imposed because proof of disability is considered doubtful at these ages, due to the difficulty of distinguishing between it and old age. This same reason applies to the general practice of not including the waiver of premium provision in policies sold to persons aged, usually, 55 or over.

In most policies, maturing benefit provisions state that, if the disability continues to age 65, the cash surrender value of the policy adjusted for any debits or credits becomes payable and the policy terminates. As a result, disabled persons of 65 and over commonly lose their insurance coverage.

Similar provisions exist in many group contracts, with the key distinction that the cash surrender value becomes payable and the policy terminates if the disability is continuous for more than a stated period of time such as five years, this situation being regarded as effective termination of employ-

ment. Vesting of the cash surrender value occurs over the five year period, reducing the face amount of the benefits to be paid should the insured die before the five year period.

### *Observations*

The Committee, in reviewing industry practices with respect to the waiver of premium rider, addresses the following observations and recommendations to the life insurance industry.

1. The cost of the waiver of premium rider is in some cases “hidden” in the annual premium for the life insurance policy. Disclosure of the cost of this rider would assist in price comparison and encourage greater competition. The Committee believes such disclosure is essential and should be part of the system of disclosure outlined in Chapter 9 of this Report.
2. The definitions of total and permanent disability under the waiver of premium rider are not consistent among companies. This tends to introduce an element of variability into coverage which is difficult for the consumer to assess in making a product choice. Standardization of the definition of disability under a waiver of premium rider, including its application to non-employed persons, should be considered. Other areas of variability, including differences in maturity benefit provisions and in underwriting standards, also complicate consumer choice and should be reviewed by life insurance companies with the intention of standardization.
3. In addition, the limit of six months before benefits are collected may be too long for some policyholders. The Committee suggests that more options might be made available by life insurers.
4. Some policies permit reinstatement of the policy within one year after policy lapse with proof of disability at the time the policy terminates. The Committee finds this provision to be a beneficial practice on the part of some insurance companies and urges other companies to adopt this provision.

### **3. Accidental Death Benefit**

The accidental death benefit is commonly known as a double or triple<sup>1</sup> indemnity rider, which provides in the case of accidental death for payment of additional amounts of insurance, frequently up to twice or sometimes three times the face amount of the policy. Most policies stipulate that death occur within ninety days after injury for payment to be made. Almost every company offers this option, typically at an extra price based on the face amount of the policy. Coverage typically ends at age 65 or 70.

1. Less common today; more common in the United States.

The rider generally excludes various risks as follows:

- suicide
- inhaling gas, taking poison, drugs or medicine, voluntarily or otherwise
- physical or mental infirmity, medical or surgical treatment, illness or disease or any kind
- committing or attempting to commit a criminal offence
- insurrection, civil commotion, war
- aviation as a hobby or occupation.

### *Period within which Death must occur*

The insured must die within 90 days of the accident and as a result of the accident for his beneficiaries to collect under the accidental death rider. The 90 day limit on accidental death coverage may be too restrictive for those kept alive by artificial means. An extension of this limit to 180 days has been proposed, with uniform application for all companies.

Related to this suggestion is the following comment by the CLIA:

“The accidental death benefit is intended to provide coverage only if the death of the life insured is caused solely by accidental means. The longer the life insured survives an accidental event, the more difficult it becomes to pinpoint whether the accident or a significant illness was the true cause of death. For this reason life companies usually limit their liability under the benefit to deaths occurring within 90 days after an accident. If, however, the circumstances surrounding a death clearly indicate that the death was caused solely by accidental means and not contributed to in a significant way by a pre-existing illness, it is most unlikely that a life company would invoke the 90 day limitation. This practice was confirmed at the Annual Meeting of the Claims Section of the CLIA in November of this year.”<sup>1</sup>

### *Underwriting and Availability*

The accidental death rider is underwritten separately from the basic life insurance policy. Actuarial tables based on accident frequency are available to set standard rates. Generally, the rider would be offered at standard rates to applicants rated as standard for the basic policy. Exceptions occur, however, when underwriters believe there may be factors due to age or medical or physical handicaps concerning the applicant that, while not requiring the basic policy to be rated substandard, indicate that the rider should be either denied or surcharged. The rider would be denied or rated above standard for high risk policyholders. Variations of interest follow.

1. Supplementary submission to the Ontario Select Committee on Company Law from the Canadian Life Insurance Association, December 1979.



### *a) Medical Impairments*

Certain impairments, such as heart disease, could cause sudden death in circumstances in which a claim for the accidental death benefit would be made, and yet death was due to disease, not accident. Certain other impairments, such as deafness or impaired eyesight, may make the applicant more prone to accident than a normal person. Thus, although the impairment may be rated as standard for a life policy, it will be rated separately for the accidental death rider.

### *b) Habits and Moral Hazards*

Past records of over-indulgence in alcohol or reckless automobile driving are said to require special consideration, and possible rejection of the accidental death rider.

### *c) Occupation*

Persons rated for occupation on the basic policy are rated on occupation for the accidental death rider, with a few rare exceptions.

### *Extent of Purchase*

At the end of 1978, \$29.1 billion of accidental death benefits were in force in Canada with federally registered companies as against \$140.4 billion of individual life insurance in force. Thus 21 percent of the business in force has this benefit attached. Traditionally, this benefit has been even more popular in the United States and it has been stated that as much as 50 percent of ordinary business sold by large U.S. companies includes the accidental death benefit.

The popularity of the accidental death benefit is described by the following:

“Unlike the total disability benefit, the D.I.<sup>1</sup> benefit makes a strong appeal to the man in the best of health; he thinks death by disease rather remote, but is aware every day of death by accident, to which much publicity is given. By combining the D.I. benefit with life insurance the benefit can be obtained at a very low rate. The suddenness with which accidental death strikes, with the insured’s dependants totally unprepared, is justification for it on economic grounds.

The sales appeal of the benefit is important. That for the addition of a dollar or so a thousand to the premium, double the sum insured is payable on accidental death has a major sales appeal particularly as so many people realize they are underinsured. On the other hand the critics of the benefit maintain that it is wrong to concentrate on death from

1. D.I. indicates double indemnity.

any particular cause. Further they maintain that every dollar available should be devoted to increasing the sum insured payable on death, whatever the cause, and that this can be achieved with little extra cost, for the premiums for term riders at the younger adult ages are quite low.’’<sup>1</sup>

### *Premiums and Claims*

Premium income for the accidental death rider on ordinary or individual business in Canada in 1978 amounted to \$26 million. Claims incurred in 1978 amounted to \$12 million; however, these amounts are not related to the premium income received in that year. No data are available to indicate what proportion of premiums earned accrue to policyholders in the form of benefit payments. Furthermore, premium income and claims experience for group benefits are not known. Lack of data on the accidental death rider is in part due to federal legislation which permits a life insurance company to issue this rider without the necessity of making it a separate class of business.

### *Observations*

The Committee, in reviewing industry practices with respect to the accidental death rider, addresses the following observations and recommendations to the life insurance industry.

1. The accidental death rider provides additional coverage only in the situation of death by accident. It has been argued before the Committee that, if the need exists for additional insurance, it exists regardless of the circumstances of death.

The Committee believes that the insured should be made clearly aware of the alternative to buy full life insurance coverage, on a term basis if appropriate, rather than pay a premium for an accidental death rider. Such information should be provided to the prospective policyholder at the point of sale, as part of a system of disclosure to be detailed in Chapter 9 of this Report.

2. The cost of the accidental death rider is sometimes “hidden” in the annual premium for the life insurance policy. In the Committee’s view, this practice hinders price comparison among companies. It also hinders the consumer’s evaluation of alternatives, such as purchase of a supplemental term policy or a term policy rider. The Committee recommends that all life insurance companies in this Province undertake to disclose the cost of the accidental death rider separately from the cost of the basic life insurance policy.
3. The accidental death rider can be denied on the basis of certain un-

1. Arthur Pedoe and Colin E. Jack, *Life Insurance, Annuities and Pensions*, University of Toronto Press, 3rd Edition, 1978.

derwriting criteria related to the perceived increased risk of accidental death. For example, it is not offered after a certain age as poorer health could precipitate an accident. The underwriting criteria for denial of the rider are not consistently determined nor are they necessarily determined objectively on actuarial evidence.

The Committee expects that the insurance industry, given its current technological capability to collect and analyze underwriting data, will begin to eliminate underwriting criteria used to rate the accidental death rider, where such criteria cannot be determined objectively based on actuarial evidence.

4. The Committee shares the concern that the 90 day limit, within which the insured must die as a result of accident for his beneficiaries to collect on the accidental death rider, may be too restrictive for those kept alive by artificial means. The Committee urges the life insurance industry to develop a more flexible provision in its life insurance contracts that allows for claims to be accepted beyond the 90 day period if reasonable proof can be given that death occurred as a result of accident.

#### **4. Guaranteed Insurability Rider (Guaranteed Policy Option)**

The guaranteed insurability option is available only on whole life policies. It is normally sold, at an extra cost, to applicants in their twenties and thirties. It guarantees the policyholder the right to buy additional whole life insurance *at standard rates* regardless of changes in health or occupation. Noteworthy to the insured is the fact that the incontestability provisions and suicide clause in policies usually begin anew for the extended amount of insurance purchased under a guaranteed policy option.

Variations among companies in the terms of this option centre around:

- the total amount of additional insurance that can be bought, based usually on the face amount of the original policy;
- the age limit to which extra purchase can be made, commonly until age 40; and
- the intervals at which new purchases can be made, typically every three years, or sometimes with the birth of a new child.

Typically the guarantee of insurability extends only to age 40. The chances of becoming uninsurable before age 40 are very limited and hence this option may not be of benefit to those who need to extend their coverage most.

The guaranteed insurability rider is only available to risks rated as standard for the basic policy. If there are any risks associated with medical impairments, occupation, avocation, aviation or morals, the rider is refused.

The guaranteed insurability rider is a relatively new option available

with the purchase of a whole life policy. There is as yet no common statistical base of mortality experience available to insurers upon which they can base their pricing of this option. Actuaries in fact visualize difficulty in developing a statistical base and hence expect that rates will continue to be established largely on subjective bases.

In sum, no data are available to indicate the extent to which the guaranteed insurability policy rider is provided, the cost of this option, or the extent to which additional purchases of life insurance occur under the terms of this rider. There is as well no reliable statistical base for underwriting this option on a consistent actuarial basis.

It has been suggested that there is a need to provide the consumer with the option of purchasing term coverage under the guaranteed insurability rider. Term coverage bought, for example, at the time of birth of a child, might be more appropriate to family needs than an extension of cash value insurance. Term coverage, including term coverage that is both renewable and convertible without evidence of insurability to at least age 65, is suggested as a necessary option under this rider.

### *Observations*

1. It is the Committee's expectation that the life insurance industry will provide term insurance as an option under a guaranteed insurability rider, such that the policyholder, in exercising his right to buy additional amounts of insurance at standard rates, will have a choice of additional amounts of either term or whole life coverage. The Committee believes this choice should be made available under all guaranteed insurability riders sold.

## **G. SALE OF LIFE INSURANCE TO SINGLE PERSONS, CHILDREN AND NON WAGE-EARNER SPOUSES**

One aspect of the marketing of life insurance policies which touches in part on the "savings" aspect of life insurance and certainly on the appropriateness of life insurance versus alternative use of funds is that of the sale of life insurance to single persons, to children and to non wage-earner spouses.

### **1. Precautionary Need**

It is generally acknowledged that "the primary purpose of life insurance is to protect dependants financially against the untimely death of their breadwinner"<sup>1</sup>. The Committee has heard criticisms that the industry sometimes departs from this primary purpose with the sale of policies to the market segment consisting of single persons, children and in some cases non-wage earner spouses.

1. *The Consumers Union Report on Life Insurance*, Consumers Union of United States, Inc., 1977,



The primary reason for selling insurance to this market segment is precaution—because some day there may be children or other dependants to care for and uncertainty about future insurability “favours” insuring with *permanent* coverage now. Added benefits of insuring “now” include reduction in future insurance costs by insuring while in good health, and a guarantee of the right to purchase higher amounts of insurance in the future.

Other arguments favouring insurance on non wage-earners or persons without dependants include provision for funeral costs in the case of single persons, and provision for housekeeper or child care costs in the case of death of a homemaker spouse. Either permanent or term insurance could suit these requirements.

Reasons related to the “savings” rather than protection aspects of insurance include “forced savings” for specified purposes such as a child’s education, build up of a “nest egg”, or an emergency fund and a fund for future policy loans. Purchase of a whole life or an endowment policy is recommended by the industry to satisfy these latter insurance needs.

Some indication of the extent of insurance issued on the lives of juveniles, young adults and non-employed persons is provided below.

## 2. Insurance on the Lives of Single Persons, Children and Non Wage-Earner Spouses

LIMRA analysis of the distribution of policies issued in Canada in 1978 shows that the number of policies sold to juveniles is about one in five, as illustrated in the following table:

TABLE 4  
DISTRIBUTION IN CANADA OF 1978 POLICIES,  
PREMIUM AND VOLUME—ALL AGENTS  
(Sample of 29 companies doing business in Canada)

	Percent of		Volume of
	Policies	Premiums	In Force Business
On male adult lives	55%	72%	77%
On female adult lives	27	20	17
On juveniles (15 or under)	<u>18</u>	<u>8</u>	<u>6</u>
Total	<u>100%</u>	<u>100%</u>	<u>100%</u>

Source: LIMRA, The 1978 Buyer Study (Canada).

Noteworthy also is a LIMRA study on the 1974-1975 experience of six companies writing in Canada. In the case of those six companies, 32.7 per cent of new business was sold on insureds aged 19 or less.

Within the adult group (those over 15 years of age), LIMRA notes that “the primary age market for life insurance has long been the under-25 adult group”. The 15 to 24 age group represented some 26 percent of the adult population in 1978, whereas 37 percent of new policies issued to adult insureds were to this age group. U.S. experience has shown a decline in sales on the lives of younger adults relative to their share of population and, to a lesser extent, this trend is becoming evident in Canada. Changing attitudes toward personal and family commitments are likely one of the factors in the trend to fewer sales at younger ages. A shift of population out of the under-25 age groups is also influencing the overall mix of new adult insureds.

The distribution of new sales to adults who are likely not to have family support responsibilities is shown in the table below.

**TABLE 5**  
**SALES IN CANADA OF LIFE INSURANCE POLICIES BY**  
**SELECTED CHARACTERISTICS OF ADULT LIVES (AGES OVER 15)**

	Percent of Total Policies Bought by Adults by Sex	
	Ordinary* Agent Sales	Combination* Agent Sales
<b>Males</b>		
Single (only)	30%	43%
Unmarried (single, widowed, divorced, separated)	32	46
Age 16-19	8	15
Students (16 and over)	5	7
	Percent of Total Policies Bought by Adults by Sex	
	Ordinary* Agent Sales	Combination* Agent Sales
<b>Females</b>		
Single (only)	32%	38%
Unmarried (single, widowed, divorced, separated)	42	50
Age 16-19	12	18
Students (16 and over)	5	6
Homemaker, unemployed	26	32

\* Ordinary agents sell on an annual or periodic payment basis. Combination agents sell on a debit payment basis as well as an ordinary payment basis.

Source: LIMRA, 1978 Buyer Study (Canada).

It would appear from this study that a significant proportion of new life insurance policies is written on the lives of non wage-earners or persons without dependants.

## Observations

In sales of insurance to non wage-earners or persons without dependants the life insurance industry asks consumers to decide at the time of purchase whether they may wish to purchase coverage or additional amounts of coverage at some future date conditional upon need and upon ill health at that future date. They in effect ask consumers to make a purchase decision under a great deal of uncertainty about future events. There is some evidence that has come to the Committee's attention that individuals may, with a certain sequence of presentation of information, tend to over-insure in such situations.<sup>1</sup>

As mentioned above the Committee finds that some policies are sold for reasons which are not related to death protection, such as an educational fund or provision for an emergency or loan fund. The consumer must evaluate the relative merits of "insuring" for these needs versus saving or investing. However, some consumers may be unfamiliar with other alternatives and, hence, may not make an optimal decision for their individual circumstances. Therefore, there would appear to be reason for concern when life insurance policies are sold as savings vehicles rather than for the primary purpose of death protection.

It is impossible for the Committee to judge whether consumers are making the right choices in buying insurance for non wage-earners or persons without dependants or whether insurers are fairly explaining the case for insurance, without undue emphasis on uncertainty. But, when funds are diverted from needed, higher amounts of insurance on the breadwinner to less essential insurance on a spouse or children, there would appear to be some reasons for concern.

Accordingly, the Committee is convinced of the importance of information provided to the prospective policyowner at the point of sale. The Committee will comment on the nature of information to be provided to all policyowners later in this Report in Chapter 9.

## H. LAPSATION

### 1. The Lapsation "Problem"

The termination of a life insurance policy before death or maturity of the policy may have adverse effects on the buyer of the policy, on the beneficiary and on the agent, the company and the life insurance industry. To the extent that harm results from early termination of a policy, there can be said to exist a problem in the life insurance industry from such termination or "lapsation" of policies. Lapsation is defined as the termination, with or

1. D. Kahneman and A. Tversky (1979), "Prospect Theory: An Analysis of Decision Under Risk", *Econometrica*, 47(2), as interpreted in G. F. Mathewson, "Information, Entry and Regulation in Markets for Life Insurance", August 1979, Draft submitted to the Ontario Economic Council.

without value, for any reason except death, conversion or maturity, of business in force.

The potential for harmful effects is greatest in the first year of the policy when lapsation creates serious losses to consumers and to the industry. Lapsation continues as a problem over the lifetime of the policy in that hardship may be suffered by dependants when the insured dies without adequate insurance, because of termination.

Studies<sup>1</sup> of the first-year lapse rates of Canadian life insurance business report that, at the end of 1978, 11.9 percent of individual policies in force, by face amount of policy, lapsed before the 13th month policy anniversary date. A similar survey shows a higher first-year lapse rate in the United States, of 15.0 percent.

Persistency is the converse of lapsation and refers to the number of policies still in force. Further studies<sup>2</sup> show that the better persistency of Canadian business lasts about eight or nine years, after which United States business has better persistency. However, the better experience in the early policy years for Canadian business offsets the later higher lapsation. As a result the average lapse rate for Canadian experience for the policy years 1' to 15 combined is 6.1 percent, compared to a United States average of 7.7 percent.

Data provided by the Federal Superintendent of Insurance are a further source of information on policy lapsation for all federally registered companies. Shown in Table 6 are ratios of gross amounts of ordinary and industrial insurance terminated, by reason of both surrender and lapse, to gross amount in force at the end of the year. Comparative ratios for previous years are also shown as well as comparison to terminations by death, maturity, disability and expiry. Noteworthy is the increase in the ratio of terminations by surrender and lapse in recent years.

Combining lapse rates with mortality rates it is possible to derive an "expected lifetime" for policies at successive years after issue. Applying lapse and mortality rates to hypothetical groups of policies issued at the age groups indicated in Table 7, LIMRA determined for each such group the number of policies that would remain in force—that is, not be terminated by death or lapse—at successive years after issue. The values in Table 7 were published by LIMRA in 1975 based on then available data on lapse rates and mortality rates for policies issued in the United States. Comparable analyses of the lifetime of permanent policies are not available for Canada.

1. LIMRA, *The Long-Term Lapse Study, 1974-1975 Canadian Experience*, Research Report 1979-2.  
2. LIMRA, *13-Month Ordinary Lapse Survey*, Year 1978.



**TABLE 6**  
**RATIOS OF GROSS AMOUNTS OF LIFE INSURANCE**  
**TERMINATED TO GROSS AMOUNTS IN FORCE—**  
**FEDERALLY REGISTERED COMPANIES, CANADA**

	1955	1965	1975	1977	1978	Gross Amounts Terminated During 1978 (\$'000)
Terminated by death, maturity, disability and expiry—						
Canadian Companies	0.81	0.90	0.74	0.64	0.73	\$ 700,629
British Companies	0.53	0.59	0.50	0.60	0.59	69,776
Foreign Companies	<u>1.91</u>	<u>1.59</u>	<u>2.08</u>	<u>1.98</u>	<u>1.87</u>	<u>563,080</u>
All Companies	<u>1.09</u>	<u>1.05</u>	<u>1.03</u>	<u>0.93</u>	<u>0.96</u>	<u>\$ 1,333,485</u>
Terminated by surrender and lapse—						
Canadian Companies	4.59	6.14	6.12	7.02	7.58	\$ 7,304,712
British Companies	5.36	7.42	8.68	8.74	9.14	1,076,568
Foreign Companies	<u>4.59</u>	<u>6.67</u>	<u>6.29</u>	<u>6.73</u>	<u>6.64</u>	<u>1,998,382</u>
All Companies	<u>4.61</u>	<u>6.35</u>	<u>6.37</u>	<u>7.10</u>	<u>7.51</u>	<u>\$10,379,662</u>

Source: Report of the Superintendent of Insurance, Ottawa, 1978.

**TABLE 7**  
**LIFETIME OF PERMANENT LIFE INSURANCE POLICIES**  
**IN THE UNITED STATES**

Issue Age(s)	Expected Lifetime <sup>1</sup>	Median Lifetime <sup>2</sup>
0	27.93 yrs.	23.40 yrs.
1	26.14	21.77
2-4	24.03	19.19
5-9	23.15	17.00
10-14	24.87	17.58
15-19	20.12	11.23
20-24	17.77	7.61
25-29	19.61	11.11
30-34	19.68	15.20
35-39	19.09	17.28
40-44	18.31	18.23
45-49	16.69	16.68
50-54	15.01	14.74
55-59	13.35	13.32
60-64	11.94	12.62
65-69	10.90	12.09
70+	8.50	9.22
ALL <sup>3</sup>	19.53	13.60

1. The "expected lifetime" of the policies in each issue age group is the number obtained by dividing the total number of years in force experienced by all policies in the group by the initial number of policies in the group.
2. The "median lifetime" for each issue age group is the duration at which exactly 50% of the policies in the group still remain in force.
3. An average of the figures for each issue age group weighted by issue age distribution.

Source: LIMRA, 1975, based on U.S. data.

Noteworthy is the low expected and median lifetimes of policies issued at ages 20 to 24. A very high lapse rate is the primary factor in the low lifetimes shown for this age group.

Noteworthy also is the fact that for each issue age group below the 45-49 age group, at least 50 percent of the policies in the group do not remain in force up to age 65. Again this is the result of terminations more than it is the result of deaths. The analysis in the above table appears to demonstrate for the United States that lapsation affects a significant proportion of permanent life insurance policies. As a result a significant number of these policies do not remain permanent.

## **2. Effects of Lapsation on the Consumer**

The effects on consumers of termination of a policy before death or maturity include the following:

- first, coverage is terminated and can result in hardship for the insured's beneficiaries;
- second, the policyholder's coverage up to the point of policy termination is purchased at a higher cost than if the policyholder had purchased for the period the policy was in force; in the case of the termination of a permanent policy, the policyholder would have paid much higher whole life rates for coverage than if he had bought term coverage;
- third, the insured may suffer a financial loss on cash value policies if coverage is terminated in early years while cash value build up is low; and
- fourth, the cost of lapsation to the life insurance industry may be passed on to "persisters" or new policyholders in the form of higher premiums or lower dividends.

To understand the latter form of injury to consumers fully, it is necessary to examine the effects of lapsation on the cost of insurance.

## **3. The Effects of Lapsation on the Cost of Insurance**

Inherent in all premiums are certain assumptions regarding mortality, interest, expenses and profit. As lapsation as well as mortality affect the average lifetime of a policy, insurers also take lapsation rates into account in setting premiums.

All other factors being equal, companies with low lapsation rates experience a longer lifetime for their policies and are able to set lower premiums and perhaps pay higher dividends to participating policyholders than companies with higher lapse rates.

If actual lapses differ from the rates assumed and the company feels the differences will continue, the company may adjust the premiums charged

for new sales. That is, a shift in lapse rates may cause higher or lower premiums for new buyers. With participating insurance, differences between actual and assumed lapse rates may be reflected in the short-term in higher or in reduced dividends for persisting policyholders.

A recent U.S. report on policy lapsation<sup>1</sup> includes a study showing the effects of nil, medium and high lapse experience on dividends, and therefore net insurance cost, and observes "the higher the lapse rates, the more costly the insurance". Further, nonquantifiable effects of lapse are also reported to be felt by the company. The report states: "There is a negative effect on the company, looking into the future . . . This comes from such factors as:

- A smaller number of units are available to bear fixed overhead and administrative expenses. As policies lapse, there will be fewer to bear these expenses and the resulting expense per policy would grow, clearly affecting the cost of insurance for persisters (nonlapsed policyholders) in a negative fashion.
- A deterioration in agent earnings, morale and eventually retention can occur as lapses rise. This would lead to increased expenses and thus a worsening of insurance cost.
- Assets might have to be held in a more liquid form than they would if there were no lapses, or at least if there was a substantially lower lapse level. This can occur particularly when investment returns on longer range investment commitments are at relatively high rates. Liquid assets earn, typically, a lower rate of return. Thus, the cost of insurance is increased through a lower overall interest rate that can be reflected in the pricing."

It must also be recognized that not all high rates of lapsation lead to a negative effect on the cost of insurance. After a certain point in the policy aging process, assets acquired with premium income exceed the liability reserves of the policy and at this time the company will be making a profit from the lapse of the policy. The profit earned by the life insurance company in such lapse situations may find its way to persisting or future policyholders by way of reduced premiums or higher dividends. In fact insurers with high late lapsation levels may find themselves better able to compete for new business on the basis of lower net premiums, this competitive advantage being earned at the expense of lapsing policyholders.

While lapsation can result in losses to consumers and in an increased cost of insurance, a total lack of lapse is neither possible nor desirable. Needs for insurance change, making termination desirable in some situations. New products are developed or introduced to the consumer that better suit his needs and result in termination of existing policies. For such reasons

1. Report to the National Association of the Insurance Commissioners, by The Industry Advisory Committee on Policy Lapsation, December 1978.

lapse cannot be eliminated entirely although a reasonably low level of lapse is an industry objective, if only for the reason that lapsed policies reflect adversely on the industry and cause public wariness of life insurance.

#### **4. Causes of Lapsation and Possible Solutions**

Identifying the causes of lapsation is a complex matter. Studies of lapse rates show that lapse rates vary as between Canada and the United States, that within either country they vary by company, by agent, by type of product, by type of buyer, by risk classification, by mode of payment and by size of policy. In general the nature of the product and the purpose for which it is purchased would appear to determine the chances of a policy lapsing, but other factors such as a buyer's economic situation also bear heavily on the decision to terminate coverage.

An Industry Advisory Committee on Policy Lapsation reported in December 1978 to the National Association of Insurance Commissioners in the United States on its analysis of the lapsation problem and its causes. The report noted that "a literature search on persistency discloses the fact that an exhaustive amount of research has been done over the years on the factors affecting persistency" and that these studies provide insight into causes of lapsation, and action which can be taken to reduce the incidence. Its summary conclusion with respect to the factors affecting persistency was expressed as follows:

"persistency . . . depends on:

- to whom the insurance is sold
- what insurance is sold
- who sells it, and
- what happens after the sale."

The report to the National Association of Insurance Commissioners then listed a number of practices which are already in use in one form or another to reduce lapsation rates. Included were:

- Compensation of field personnel
- Agents' honor clubs or conventions
- Agent selection, training and supervision
- Termination of agents
- Special supervision of agents with poor persistency
- Reduction of emphasis on modes of business with poor persistency
- Home office systems geared to respond to delay premium payments, cash surrender requests and lapses
- Education of new and existing policyowners
- Efforts in the home office to study or survey their lapsed business
- "Jawboning", that is, in-house discussions on reduction of lapse rates
- Use of a "persistency rating" system that predicts the likelihood of early lapse of a policy.



Most of these practices relate to the marketing of insurance, by having better trained and educated agents who sell policies that are suitable for the public's needs, and who will not sell unwanted insurance.

The last practice listed above differs somewhat from the others as it pertains to the underwriting process. Most companies employ a method of screening applications based on broad underwriting and other criteria. This screening process is designed to identify those applications which are likely to be accepted, rated or declined and is also used to identify those application requests which might result in an early policy lapse. As a result of the screening process, some applications may be declined or a change may be suggested in the insurance program. It appears, however, that applications are very rarely declined in Canada on the basis of other than medical or occupational factors such as on the basis of a low "persistency rating".

## **5. Observations**

No attempt is made in this Report to study the causes of lapsation, although such study would be necessary to determine precisely what action can be taken successfully in this Province to reduce the incidence of lapsation. The Committee's conclusions with respect to the matter of lapsation are outlined under Section K at the end of this Chapter.

## **I. REPLACEMENT OF LIFE INSURANCE POLICIES**

### **1. Replacement as an Issue**

It is apparent from the foregoing sections that the life insurance industry provides many types of life insurance coverage for varying consumer circumstances. But circumstances vary not only from policyholder to policyholder but also over the lifetime of any one insured. It is unlikely therefore that individual needs for protection will remain constant over the lifetime of many policyholders. In such situations a policyholder may wish to change his coverage; he may decide to do so by replacing one policy with another.

Replacement, however, poses a problem for insurers and for agents. It is an aspect of the greater problem of lapsation or premature policy termination discussed in the previous section.

Replacement also poses a problem for insurers because it means that life insurance is treated as a "mere" commodity rather than as a continuing contractual and client relationship. As a disposable or replaceable commodity, the life insurance product would need to be redesigned, as would its pricing structure and the compensation structure for selling and servicing the product. It is felt that such redesign would not be in the best interests of policyholders as it could eliminate the concept of permanent coverage and it could make impractical the time and effort now spent in advising the con-

sumer on an income protection program. Hence, replacement is viewed as a problem which must be controlled so as not to undermine life insurance as continuing protection and service to policyholders.

Replacement also poses a problem for regulators. Replacement is of concern because the purchaser of coverage may not understand the economic consequences of policy termination. For example, the insured loses the benefit of increasing cash and paid-up values under the contract being surrendered. The values he has accumulated under the policy in force may not have had time to develop to a point where they no longer represent a financial loss to the insured. Furthermore, the insured may not understand that a new contract will subject him once again to being rated at an older age, to incurring the initial costs of setting up a contract, and to the re-application of suicide and incontestability provisions in his contract.

Although industry and regulatory representatives alike have for many years expressed concern over the problems associated with replacement, both groups now appear to agree that the replacement of one life insurance policy with another is appropriate in some situations.

## **2. The Extent of Replacement**

The Committee is informed by the CLIA that no factual assessment of replacement activity has been made in Canada. Similarly in the United States, LIMRA has reported that few companies maintain detailed records relating replacements to voluntary terminations or to lapses.

One of the few efforts to document the extent of replacement activity has been made by Prof. William C. Scheel of the University of Wisconsin, who conducted a study in 1975 for the Wisconsin Department of Insurance from a sample of 60 companies. Mr. Scheel reported the following from his sample survey:<sup>1</sup>

- Replacement activity was found, on the average, to be low. The average percentage of 1975 new business that constituted replacements was 2.5.
- Whole life insurance was the most commonly replaced type of policy; a total of 50% of replacements were from whole life plans. Endowment plans and paid-up policies constituted another 10% and 13% respectively of plans that were replaced. Term plans made up the remaining 27% that were replaced.
- Whole life insurance was also the most common type of policy purchased as a replacement, constituting 52% of proposed replacements. Term policies, about equally split between level and decreasing plans, were used in 32% of the proposed replacements. Paid-up policies comprised 12% of replacement policies and endowments only 4%.

1. As reported by Janice M. Pasculli, "Replacement Push Troubles Industry", *National Underwriter*, May 6, 1978.

- It was found that 51% of insurance being replaced did not pass its second year of being in force. Such rapid replacement is known as “churning”.

A 1979 LIMRA research study on *Buyer-Initiated Sales and the Agency System* also attempted to look at replacement. It found from a limited sample, drawn from only six companies, that 17 percent of sales were replacements, with 31 percent of these internal replacements. It is cautioned that these numbers may not reflect industry experience with any accuracy.

It is apparent from comparing these two sources that there is some disagreement over the extent of replacement activity as an average percentage of new business written.

### 3. Types of Replacement

It is difficult to make a clear distinction between “good” and “bad” replacements. “Bad” policy replacements have been characterized as:

- initiated by agents who are only looking for ways to make additional commission income;
- initiated by “financial advisors” who encourage consumers to take their life insurance cash values and invest them outside the insurance industry;
- condoned by companies who feel they have better, newer products to offer consumers.

In examining the motives for “bad” replacement, it is suggested by Mr. Scheel, from his Wisconsin study, that “the high proportion of young policies that are replacement targets lends support to the notion that first-year commissions may be the motivating factor (behind “bad” replacement) far more often than ‘stealing’ cash values”.<sup>1</sup> This observation, made also by many others critical of the life insurance industry, has tended to point to supervision of agents’ selling practices and to adjustment of commission schedules as methods of reducing unnecessary replacement.

It is interesting to note that “bad” replacements caused by misrepresentation are a long-standing problem in the North American insurance industry, recognized in the late 1800’s, rampant in the 1930’s in both Canada and the United States when replacement business was largely the only source of “new” business available to agents, controlled in the 1940’s in the U.S. by an inter-company committee on replacements and prohibited under Unfair Trade Practices Act in most U.S. states since the mid-1940’s.

However, it is apparent that “good” replacements also exist.<sup>2</sup> They

1. Janice M. Pasculli, *op. cit.*

2. A study of replacement activity in the United States by Professors W. C. Scheel and J. L. Van Derkei found that the majority of replacements were “acceptable”, that is represented a cost saving for the policyholder. See reference on page 75.

may be initiated by an agent, an advisor or by the policyholder himself because the initial sale was not appropriate or because the policyholder's needs have changed. In these instances attention must be paid to factors which inhibit replacement. Such factors include:

- commission rate structures which penalize agents for undertaking within his own company's range of products, a replacement of, say, a whole life policy with perhaps a different type of policy such as a term policy; and
- regulations or paperwork which make the process of replacement unduly difficult or onerous for both agent and insured.

To resolve the conflict between good and bad replacements, recent proposals for reform of regulation pertaining to replacement have attempted to strike a balance between:

- first, the matter of twisting or inducement of an insured to lapse a policy to his detriment;
- second, the matter of disclosure of useful policy information to the insured to allow him to make an informed decision on the advisability of replacement in his particular individual circumstances.

A review of regulations pertaining to replacement and proposals for amendment to such regulations follows.

#### **4. Current Regulation of Replacement—Ontario**

Under the Ontario Insurance Act, twisting or inducement of an insured to lapse a policy to his detriment is an offence, prohibited in Section 357 of Part XIV, under an amendment made to the Act in 1971. This is known as the "anti-twisting provision".

To protect the insured's interest further, a Regulation to the Act was promulgated in 1974. This Regulation, first, prescribes the duties of agents and insurers in situations involving the replacement of a contract of life insurance and, second, prescribes a comparison disclosure form which must be completed in each situation of replacement. Because of the second matter, this Regulation is oftentimes referred to as the "replacement regulation".

It should be noted that the current provisions with respect to twisting and replacement regulation are not applicable to term insurance.

##### *a) The Anti-Twisting Provision*

In regard to the anti-twisting provision in the Act, LUAC has stated that under the present provision "any replacement induced by another person is an offence". This inhibits good replacements. LUAC recommends two amendments to the current provision:



- That the offence of twisting should be restricted to those situations where the replacement would be “to the prejudice” of the policyowner or “detrimental to the interest” of the policyholder.
- That the application of the offence of twisting should be extended to all types of life insurance and annuity contracts including term insurance.

LUAC further comments that in the proposal for amendment of Part XIV of The Insurance Act, dated November 1977, it was suggested that the offence of twisting be eliminated and reliance placed on the replacement regulation. LUAC is strongly of the opposite opinion that the offence of twisting should not be deleted but should be retained but amended as suggested above.

The Superintendent also commented in his submission to the Committee on the topic of replacement. He indicated that there is a degree of conflict between the current anti-twisting provision in the Act and the replacement regulation in that replacement of one type of life insurance policy with another may be appropriate for the policyholder in some situations. It has been alleged that the current legislation protects only insurers and agents by making the process of replacement unduly difficult.

The Superintendent stated that it is argued that:

- “1. replacement by a new-money policy may be beneficial to the existing policyholder;
2. the twisting prohibition makes replacement of a policyholder’s insurance program unduly difficult;
3. Form-1 is not a good and sufficient comparison between an existing program and a new program;
4. regulation favours the agent, who sold the policy in the first place, even if he is no longer servicing the policyholder in an acceptable manner.

On the other hand and irrespective of the foregoing arguments, unnecessary and frequent twisting will, without doubt, be to the detriment of the policyholders and the present legislation affords some protection to them.”

It appears that the conflict between the intention and the effect of the current legislation led on the one hand, to the proposal to remove the anti-twisting provision from Part XIV of the Act and, on the other hand, to the suggestion by LUAC that the provision be retained but amended.

#### *b) The Replacement Regulation*

Under current replacement regulation, a comparison disclosure statement, or Form-1, is prescribed. This form attempts to ensure that members of the public have before them as much meaningful information as possible

on which to make the decision of whether or not to surrender an existing contract of life insurance and replace it with a new contract.

The comparison statement is also meant to:

- place greater responsibility on the replacing agent for the representations he makes to the insured;
- advise the existing insurer of the representations made at the time of sale and hence assist in a conservation effort;
- define a standard of information to be provided to every insured and to caution the policyholder about loss of rights under his existing policy.

However, the current replacement regulation is not applicable to term insurance and is acknowledged to contain other deficiencies. LUAC has commented thus:

“The current form which is prescribed by the Regulation has, however, some deficiencies in that (a) it does not apply to any form of term insurance which in effect is discriminatory against term insurance; (b) the applicant has the opportunity to frustrate the disclosure process by directing that a copy of Form-1 shall not be sent to the existing insurer; and (c) the Form fails to require any projection of the current scale of dividends into the future for comparative purposes.”

Further in regard to the current replacement regulation, the Superintendent had the following comment:

“In the five years since Ontario Regulation 831/74 was originally promulgated, the experience of, and studies done by, my office has indicated that there are situations in which the Regulation could be amended to more adequately achieve its intended purpose. It has also been concluded that more information which should be added to the Comparison Disclosure Statement in the hope of providing members of the public with even more of the information necessary to make an informed decision in replacement situations. My office has in recent months been conducting an intensive examination of this area and has obtained the views of the industry. We have now arrived at some suggestions for amendments to both Ontario Regulation 831/74 and Form-1, which is part of that Regulation, in the hope that the existing system might be refined to better safeguard the interests of the public and more adequately provide them with the information required so that a replacement might be considered and a decision made.”

The Superintendent's proposals for amendment of the current replacement regulation call for removal of the old provision that existing contracts contain cash surrender or paid-up values to be considered as subject to a replacement and, hence, make the replacement regulation applicable to term

insurance. The proposed amendments also provide for a new disclosure statement and comparison form to be completed by both the policyholder and the agent. The duties of agents and insurers are likewise to be amended to correspond to the requirements of the new disclosure on Form-1.

## **5. Replacement Regulation in the United States**

Developments have also been taking place in recent years in the United States to improve replacement rules. Like current regulation in Ontario, regulation in 38 of the states in the United States has focused on the premise that replacement of existing life insurance may be detrimental to insureds in many cases. A NAIC task force and a NAIC-appointed industry advisory committee reviewed the regulation of replacements in 1978 focusing on disclosure rather than on the practice of twisting. The industry advisory committee recommended that new replacement rules reflect the premise that in some instances it would benefit an insured to replace existing life insurance.

The study of replacement regulation in the U.S. ran into debate over a number of issues:

- should the agent or the company be responsible for providing policy information to the insured;
- should policy information be presented as a comparison statement or a policy summary;
- what should be considered to constitute a “timely notification” system.

The recommendations arising out of the NAIC backed studies led to proposals to revise the 1970 “model life insurance replacement regulation”. The new model regulation has a new focus: the substitution of the concept of disclosure for the concept of a comparison statement. The concept of disclosure provides that “all pertinent information” be presented in a fair and accurate manner. It is argued that this approach is preferable to that of a comparison statement which may be incomplete or unreliable because it may not provide for effective comparison of essentially different types of policies.

Nevertheless the new NAIC model retains some of the provisions of the older regulation including the requirement that a “comparative information form” be completed and that a “notice regarding replacement of life insurance” be provided to the prospect with the application for life insurance. However, the responsibility for provision of the notice and for verification of the accuracy of information on the comparative information form is placed on the replacing insurer and not on the agent.

Furthermore, the NAIC model regulation shifts emphasis away from the comparative information form to the policy summary and the sales proposal as the primary documents of disclosure. The nature of the policy summary document is intended to correspond to the requirements of “solicita-

tion regulation'' as a companion law to the ''replacement regulation''. Solicitation regulation is intended to apply to all policies, whether they are replacing or not.

The industry advisory committee in the U.S. has in effect suggested a switch of responsibility away from the agent at the time of sale to the replacing insurer. The replacing insurer is expected to provide accurate information in a disclosure statement, with sufficient time for the insured to receive and review information about both the replacing policy and the existing policy before making a final decision. The existing insurer, if it wishes to make an effort to conserve its policy, must provide information comparable to that provided by the replacing insurer in any policy summary and sales proposal documents given to the buyer.

To allow the insured to evaluate the new and existing policies and to allow the existing insurer to conserve its policy, the following requirements are proposed:

- It is suggested that replacing insurers provide a 20-day money-back guarantee with policies that may or will replace existing insurance or delay issue of the policy until 20 days after the existing insurer has been notified.
- The replacing insurer must also notify the existing insurer within 3 working days of the date on which the application is received of the possible replacement.
- The replacing insurer must provide the insured with a copy of all sales proposals so they can be made available to the conserving agent. This requirement would lead to more effective sales proposals being drawn up as agents not doing their jobs could be charged by a state insurance department.

These three requirements are intended to result in meaningful comparative information being provided to the insured. They are also intended to ensure that the existing insurer is given the chance to conserve the existing policy.

As disclosure of information to the policyholder is the intended focus of the new NAIC model replacement regulation, ''solicitation'' laws outlining the information to be provided to each purchaser of life insurance are intended as companion laws to the replacement regulation. If a life insurance solicitation regulation is not promulgated to apply to all purchases, the replacement regulation contains an alternative provision defining the necessary information to be contained in a policy summary, which under the provision must be delivered to the insured.

The policy summary is meant:

- to improve the buyer's ability to select the most appropriate plan of life insurance for his needs;



- to improve the buyer's understanding of the basic features of the policy;
- to improve the ability of the buyer to evaluate the relative costs of similar plans of life insurance.

The Committee was informed that the new NAIC model life insurance replacement regulation discussed above and adopted by NAIC in December 1978 had been promulgated in Nevada and was expected to be promulgated by 12 other states by the end of 1979.

However, controversy over replacement regulation has not ended with the NAIC model regulation. Professors Scheel and Derhei in a study of replacement activity published in 1978 stated, with reference to the old or 1970 NAIC model regulation, that:

- "The failure of the present NAIC Model replacement to present clear and concise information that is relevant and easily used is exceeded only by its failure to provide the right kind of information."<sup>1</sup>
- "The overwhelming omission in the present replacement regulations is guidelines for the manner in which the data are to be used, integrated and interpreted. There is little argument that the most important reasons that can be given for policy replacement hinge on cost considerations. The argument that cost is unimportant is indefensible for a replacement situation. Yet, no replacement regulation in effect today provides for disclosure of cost or offers a methodology by which costs can be compared validly. Cost disclosure is as important for policy replacement situation as for original issues."<sup>2</sup>

Their conclusion was a harsh one:

- "Until meaningful cost disclosure is embodied into replacement regulations, one could conclude with justification that they are a facade instigated and perpetuated by the distribution system of life insurance and designed for the self-interest of insurance agents who are more concerned with the preservation of their commissions than a dispassionate, professional assessment of the merits of individual policy replacement situations."<sup>3</sup>

Professors Scheel and Van Derhei present their own proposals for replacement regulation which go beyond current NAIC proposals. In addition to improved cost disclosure as a key aspect of replacement considerations, they suggest that a buyer's guide to replacement of life insurance be substituted for the old notice to the applicant, which the Professors felt was biased against the advantages of replacement.

1. W. C. Scheel and J. L. Van Derhei, "Replacement of Life Insurance: Its Regulation and Current Activity," 45 *Journal of Risk and Insurance* (1978), pg. 206.

2. *Ibid.*, pg. 206.

3. *Ibid.*, pg. 207.

## **6. Observations**

The Committee has found that a diversity of regulatory approaches have been applied to or are suggested for dealing with the “problem” of replacement. The Committee’s own conclusions and recommendations follow in the context of the Committee’s general conclusions with respect to life insurance products, as outlined in Section K at the end of this Chapter.

### **J. LIFE INSURANCE CLAIMS**

Without reviewing in full the provisions in legislation and in practice for settlement of life insurance claims, observations are provided here on two matters brought to the Committee’s attention:

- interest on delayed claims; and
- disappearance as cause for a claim.

#### **1. Interest on Delayed Claims**

There is no provision in legislation regarding insurer liability to pay interest on delayed claims. However, the CLIA states that many members of the public feel that a liability is incurred by the life insurance company at the date of death, although claim documents may not be filed with the company until sometime later. Accordingly the CLIA recommended in 1974 “that member companies pay interest from the date of death at a rate consistent with the rate of interest paid on policy proceeds left on deposit with the Company.”

The CLIA recommendation permits a low rate of interest to be paid if the length of delay is relatively short compared to the average period proceeds are left on deposit. The lower rate of interest is intended to cover a relatively higher administrative expense for short-term delays.

The Committee welcomes the CLIA guidelines with respect to payment of interest on delayed death claims, but it also urges the life insurance industry to give special attention to the following situations of delay:

- delay in the filing of the claim and in eventual settlement caused by disappearance or other happening which makes evidence of death of the insured difficult to establish
- delay occurring in regard to claim for waiver of premium because of disability
- delay related to the surrendering of a policy and the receipt of cash value benefits from the policy.

The Committee urges the life insurance industry to review these situations and to continue improving its policies with respect to reducing delay and with respect to payment of interest when delay in settling claims occurs. The Committee comments further on disappearance as a cause for a claim.

## **2. Disappearance as Cause for a Claim**

Before the insurance company assumes the liability of payment of a claim on a life insurance policy, proof of claim must be filed with the company. When disappearance or other happening makes evidence of death of the insured difficult to establish, difficulties arise in filing an insurance claim.

In such circumstances the matter is brought to the courts. The courts require conclusive evidence of the facts which extend beyond prolonged absence of the insured to some means of establishing that the insured's absence can be properly explained only by death. With such evidence, the court will issue an order declaring death presumed. In the case of disappearance the insured is presumed to be dead by reason of his not having been heard of for seven years.

Several problems arise in respect to a claim under these circumstances, including:

- Establishing the time of death. The onus of proving that the insured's death took place at any particular time during the seven year period rests on the claimant.
- When premiums cease to be payable. It appears that all premiums falling due up to the date of the order declaring "death presumed", would require to be paid. If the policy lapses, then the onus is on the claimant to prove conclusively that the insured died before the policy lapsed.
- Payment of interest on the claim from the date of death presumed, as discussed earlier.
- Who is the beneficiary, if the named beneficiary dies before the order declaring death of the insured presumed.

Practices in dealing with these circumstances vary across the industry and may result in hardship in some family situations.

## **K. GENERAL OBSERVATIONS AND RECOMMENDATIONS WITH RESPECT TO LIFE INSURANCE PRODUCTS WHICH PROVIDE DEATH BENEFITS**

### **1. General Observations**

In this chapter the Committee has examined life insurance products which provide death benefits. The Committee finds that the life insurance industry in this Province has responded well to the needs of consumers by offering a wide array of products and options that provide financial protection to families and dependants upon death of the insured.

The Committee's primary objective in this Chapter has been to review

the features of these products and options in the context of the Committee's concerns that;

- The consumer be able to understand in reasonable depth the choice of alternatives available to him for financial protection; and
- The consumer have the opportunity to shop around and compare products.

While the Committee emphasizes that there is an onus of responsibility on individuals to manage their affairs prudently, the Committee recognizes that most consumers are unsophisticated when it comes to matters of financial planning and that all consumers, even the most sophisticated, need appropriate information on which to base their purchase decisions.

The Committee's review of life insurance products which provide death benefits has reinforced the importance of meaningful disclosure of information in the context of life insurance. The Committee has found that the choice of products and options in life insurance is a complex one. Accordingly, in order to assist the consumer in making a reasoned choice in contemplating a purchase of life insurance, the Committee believes that the consumer requires clear, meaningful information on the products sold by life insurance companies.

At the present time, the consumer looks to his agent to advise and assist him in his insurance purchases. In addition life insurance companies support their agents' activities with training programs, policy literature, policy calculations and so on. However, the responsibility of life insurance companies to inform consumers directly and through supervision of their agents is not explicit in regulation. The Committee is strongly of the opinion that the responsibility for providing information pertinent to product choice should be made explicit in legislation as a matter of insurer responsibility and as a matter of supervisory concern.

## **2. The Duty of Life Insurance Companies to Inform Consumers**

### **4.1 The Committee recommends that Part V of The Insurance Act:**

- (a) recognize the duty of life insurance companies to inform consumers about product characteristics salient to the choice of product alternatives; and
- (b) recognize the duty of the Superintendent to supervise life insurance companies in that regard.

The Committee will comment throughout this report on its specific expectations about the types of information to be provided to consumers.

It is the Committee's general expectation that recognition of the importance of product information in The Insurance Act will, over time, reinforce



already apparent shifts in industry focus and supervisory focus towards an improved system of product information in the life insurance industry.

- 4.2 The Committee has concluded that the nature and number of products developed by the life insurance industry has grown so complex that the Office of the Superintendent must direct a significantly increased effort toward consumer protection in more than just the area of insurer solvency. In this regard, the Committee expects the Superintendent to take an active role in requiring from life insurers an explanation of their products and information activities in order to satisfy himself that adequate and fair explanation of such products is being presented to the consumer. The Superintendent's authority to request full information is already provided for in Section 14 of The Insurance Act.
- 4.3 However, the Committee is satisfied that the life insurance industry in this Province is sufficiently mature and responsible so that the Superintendent can fulfil his supervisory duties in regard to consumer information requirements without the need for prior approval of policy forms, product literature and the like. Rather, the Committee expects that the Superintendent's initiative in calling from time to time for policy information will demonstrate the government's interest in the industry's product design and information practices and will be sufficient to ensure that a mature industry is fulfilling its information duties.

The Committee suggests that the Superintendent consider periodic public hearings, requiring from life insurers a public explanation of new or existing products and information practices.

- 4.4 Should the Superintendent have reason in the future to be dissatisfied with the industry's response to its duty to inform, then the Committee recommends that the Superintendent undertake to implement more stringent reporting requirements such as prior policy approval.

The Committee now turns to its further conclusions regarding industry practices in the sale of life insurance products which provide death benefits.

The Committee has identified six principal areas to be addressed by the Superintendent and by participants in the life insurance industry to assist the consumer:

- The fundamentals of life insurance need to be defined so that they can be understood by the consumer.
- Options to renew, convert or extend coverage should be made available by all insurers at appropriate cost.
- The policyholder's and beneficiaries' rights to benefits under the policy should be clearly outlined at the time of sale and at appropriate future dates.

- Industry practices with respect to policy riders should be reviewed.
- Steps should be taken to reduce policy lapsation where it has adverse effects on the consumer.
- Replacement regulations should be replaced by a meaningful system of disclosure at the point of sale.
- Problems that arise with respect to special claims situations should be reviewed.

Each of these matters is dealt with individually below.

### **3. The Fundamentals of Life Insurance Need to be Defined**

The Committee welcomes the efforts of many life insurance companies to simplify the language in their policy contracts and to provide policy summaries and product descriptions. However, the Committee believes that the consumer would benefit from standardization in certain areas.

- 4.5 The Committee recommends that the fundamentals of life insurance be defined in a standard form so they can be understood by the consumer. In continuing with the trend to better product information, the Committee believes that standard definitions of life insurance products should be adopted by those companies carrying on the business of life insurance and by the Office of the Superintendent of Insurance in supervising the activities of the industry.

These definitions would be intended to facilitate the consumer's understanding of what he is buying, by reducing the complexity of choice to basic categories of product. Where life insurance products differ from the standard definitions, these differences should be brought to the consumer's attention.

- 4.6 To enact standard definitions, the life insurance industry and the Office of the Superintendent should cooperate in defining, in simplified language and in terms somewhat like the following:

#### *Term Insurance*

- as basically a product providing a single benefit, that of financial protection for dependants upon the death of the insured
- as temporary, for a specified term and not for as long as the insured lives
- as providing continual coverage without fear of uninsurability only upon the policy being renewable and convertible
- as having a lower initial cost than a whole life policy for the same level of coverage but as subject to increasing cost at each renewal to maintain a fixed level of coverage, as one grows older.

## *Whole Life Insurance*

- as a product providing a primary benefit, that of financial protection for dependants upon the death of the insured
- as permanent protection, providing continual coverage for as long as the insured lives, without any fear of uninsurability
- as sold on a level premium basis so that equal payments are made for as long as the insured lives—this means that, in the early years of the policy, the premiums are higher than needed for death protection
- as providing ancillary benefits, which if exercised reduce the value of the primary benefit.

Similar definitions should be developed for endowment insurance and basic combination policies. These definitions should describe each basic product in terms salient to the choice of alternative products.

The Committee strongly urges the life insurance industry to adopt a common approach to explaining life insurance, as part of its obligation to inform the consumer. This approach should be reflected in the policy contract, in product literature, advertising and in the sales process.

The Committee expects the Superintendent to assist the industry in developing basic definitions and to monitor the industry in the use of such definitions in its sales activities.

### **4. Options to Renew, Convert or Extend Coverage Should be Made Available by All Insurers at Appropriate Cost**

The Committee believes that the choice between permanent insurance or term coverage is best made by the individual, based on appropriate information related to the specific policies being considered. Essential to the consumer's choice is the availability of options that permit him to adjust his insurance program to suit his changing circumstances.

4.7 The Committee recommends that all insurers make available to their policyholders, at appropriate cost, options to renew, convert and extend coverage to either term or permanent plans of insurance. The Committee believes these options, to be exercised without evidence of insurability, should include:

- The right to renew term coverage;
- The right to convert term coverage to permanent coverage;
- The right as a cash surrender option to convert permanent coverage to various choices of term coverage;
- The right to extend coverage to larger amounts of insurance, either on a term or permanent basis, regardless of whether the initial purchase was of term or permanent insurance.

The Committee concludes that it be mandatory that all insurers offer the options listed above at the appropriate cost with all policies sold.



Most of these options are already widely sold or made available in the Ontario insurance market with the exception of options that guarantee extension of coverage in the form of term insurance.

In addition, the Committee urges that the industry and the Superintendent, in defining the fundamentals of life insurance, develop a means of alerting consumers to the options available for renewing, converting or extending coverage, without evidence of insurability.

#### **5. The Policyholder's and Beneficiaries' Rights to Benefits Under the Policy Should be Clearly Outlined at the Time of Sale and at Appropriate Future Dates**

The Committee has identified four areas related to the benefits under the policy where the purchaser of life insurance requires information. These are:

- benefits guaranteed under the policy
- benefits provided under the policy but not guaranteed as to amount
- benefits related to policy riders or options
- settlement options upon death of the insured.

The Insurance Act in Ontario does not require that the amount of insurance money payable upon death or any ancillary benefits under the life insurance contract be guaranteed or correspond to any minimum values or set of options.

- 4.8 In investigating the operations of life insurers in this Province, the Committee concludes that there is no need in Ontario at this time to set legislative standards for benefits payable under life insurance contracts or to specify what ancillary benefits or options for settlement at death or surrender should be made available as minimum requirements under contracts of life insurance. However, the Committee is of the opinion that the freedom provided to life insurers in designing policies and setting benefits requires that The Insurance Act impose a stronger obligation on life insurance companies to disclose benefit values and options pertinent to the contracts they sell.
- 4.9 Accordingly, the Committee recommends that The Insurance Act in Ontario be amended to provide under Section 149 and elsewhere if appropriate, that disclosure of all benefit values guaranteed under the contract be made mandatory and that insurers should be required to include in policies pertinent tables of benefit values for thirty years or until age 75 whichever is greater. Included should be disclosure of the amount of insurance money payable and all cash, paid-up or extended values related to contract surrender.
- 4.10 In regard to both guaranteed and non-guaranteed benefits, the Committee further recommends that the Act be amended to require mandatory disclosure in the policy of the conditions and options under which



insurance money is payable, conditions under which other benefits can be exercised including benefits to renew or convert coverage, and conditions under which benefit privileges expire.

The provision referred to in 4.10 should be applied in the case of all basic policies of permanent and term insurance, or any combination of both, and also in the case of the accidental death rider, the waiver of premium rider, and the guaranteed insurability rider. Similar provisions should apply to annuity products which will be considered in the next Chapter of this Report.

In regard to non-guaranteed benefits, mandatory disclosure of conditions under which benefits are payable is essential and falls under the preceding recommendation. Guidelines or regulations as to the format or manner of disclosure may also be required as a matter of consumer protection.

- 4.11 The Committee recommends that the Superintendent assess the need for regulations pertaining to illustrations of non-guaranteed benefits, particularly in the area of adjustable benefit policies or variable premium policies.

In this regard the Superintendent is directed to the guidelines developed by the CLIA respecting illustrations of non-guaranteed benefits to determine their efficacy in protecting the consumer.

## **6. Industry Practices with Respect to Policy Riders Should be Reviewed**

An extra dimension of complexity is added to the purchase process for life insurance in that the consumer must evaluate not only the differential characteristics of the basic policies he is comparing, but also the characteristics of various riders or policy options.

- 4.12 The Committee recommends to the industry that industry-wide standardization with respect to conditions of eligibility for rider coverage and conditions under which rider benefits can be exercised would be of significant assistance to consumers. The Committee furthermore suggests that the Superintendent undertake to review periodically the conditions under which riders are sold and the adequacy of information provided to consumers.
- 4.13 The Committee recommends that the cost of principal riders should in all cases be disclosed separately from the cost of the basic policy. The Committee believes such disclosure is essential and should be part of the system of disclosure outlined in Chapter 9 of this Report.

The Committee further emphasizes its concern that it has been unable to obtain adequate data on the ratio of benefits paid to premiums received for the principal riders it has examined. As a result, the Committee is unable to satisfy itself that these riders are priced equitably.

- 4.14 As the Committee believes that few life insurance buyers will take the time and effort to shop around for policy riders, the Committee recommends that the cost of principal riders should be determined on a consistent basis among all companies in that the Superintendent should undertake to establish a loss-ratio rule for pricing as has been developed in the case of creditor's group insurance.

Further observations and recommendations made by the Committee specific to individual riders were included in the body of this Chapter and are summarized here:

- 4.15 The Committee has reached the following further conclusions with respect to:

The waiver of premium rider:

- The limit of six months before benefits are collected may be too long for some policyholders. The Committee suggests that more options might be made available by life insurers.
- Some policies permit reinstatement of the policy within one year after policy lapse with proof of disability at the time the policy terminates. The Committee finds this provision to be a beneficial practice on the part of some insurance companies and urges other companies to adopt this provision.

The accidental death rider:

- The accidental death rider provides additional coverage only in the situation of death by accident. It has been argued before the Committee that, if the need exists for additional insurance, it exists regardless of the circumstances of death.

The Committee believes that the insured should be made aware explicitly of the alternative to buy full life insurance coverage, on a term basis if appropriate, rather than pay a premium for an accidental death rider. Such information should be provided to the prospective policyholder at the point of sale, as part of a system of disclosure to be detailed in Chapter 9 of this Report.

- The accidental death rider can be denied on the basis of certain underwriting criteria related to the perceived increased risk of accidental death. For example, it is not offered after a certain age as poorer health could precipitate an accident. The underwriting criteria for denial of the rider are not consistently determined nor are they necessarily determined objectively on actuarial evidence.

The Committee expects that the insurance industry, given its current technological capability to collect and analyze underwriting data, will begin to eliminate underwriting criteria used to rate

the accidental death rider, where such criteria cannot be determined objectively based on actuarial evidence.

- The Committee shares the concern that the 90 day limit, within which the insured must die as a result of accident for his beneficiaries to collect on the accidental death rider, may be too restrictive for those kept alive by artificial means. The Committee urges the life insurance industry to develop a more flexible provision in its life insurance contracts that allows for claims to be accepted beyond the 90 day period if reasonable proof can be given that death occurred as a result of accident.

The guaranteed insurability option:

- It is the Committee's recommendation that the life insurance industry provide term insurance as an option under a guaranteed insurability rider, such that the policyholder, in exercising his right to buy additional amounts of insurance at standard rates, will have a choice of additional amounts of either term or whole life coverage. The Committee believes this choice should be made available under all guaranteed insurability riders sold.

## **7. Steps Should be Taken to Reduce Policy Lapsation Where it has Adverse Effects on the Consumer**

The Committee is very much concerned about lapsation and the problems it poses in the life insurance industry. Although the Committee recognizes that not all lapsation is "bad", the Committee is concerned about the adverse effects on the consumer that occur in many situations when policies are lapsed.

The Committee believes that it is in the self-interest of insurance companies to undertake programs to reduce adverse policy lapsation and believes that much attention is already paid to this long-standing problem. However equal effort may not be afforded by all companies to resolving high rates of lapse.

- 4.16 The Committee is concerned about the adverse effects on the consumer that occur in many situations when policies are lapsed. The Committee believes that current levels of lapsation can be reduced.

The Committee concludes that the best means of preventing poor product choice by consumers and thereby reducing the tendency to lapse is through providing the consumer with more meaningful cost and product information at the point-of-sale and policy delivery. The Committee outlines its recommendations for such a system of disclosure in Chapter 9 of this Report.

Should current rates of lapsation persist, the Committee recom-

mends that the Superintendent consider further means to correct this problem. The Committee directs the Superintendent to consider recommending that companies regularly monitor their own lapse rates based on a specified acceptable method and disclose their rates in their annual statements. Alternatively lapse rates could be reported to the Superintendent, with the Superintendent being required to identify in his annual report companies with unusual persistency patterns, and to develop an industry standard, such as a 15 percent first-year lapse rate, against which individual companies would be compared.

As part of an improved system of disclosure, the Committee suggests, for those insurers not already doing so, that they undertake to notify policyholders, on a quick-response basis, of the consequences of a policy lapsed through non-payment of premiums or through request for surrender prior to maturity or death. By instituting or improving such notification procedures, insurers will benefit in many instances by conserving policies that otherwise might have lapsed.

## **8. Replacement Regulations Should be Replaced by a Meaningful System of Disclosure at the Point of Sale**

The Committee finds that the current replacement regulation and also the proposed revisions to the replacement regulation require policy comparison procedures and completion of forms which are difficult to understand and may well obstruct policy replacements which are in the policyholder's interest. It is the Committee's view that the most practical approach towards ensuring "good" replacements and preventing "bad" replacements is to emphasize the type of information to be provided to the prospective buyer at the time of *each* sale.

4.17 The Committee recommends that policy replacement should be treated in a manner identical to that of an original solicitation, with sufficient information being provided in both cases to provide the opportunity for a consumer to make an informed decision.

It is the Committee's general observation and conclusion with respect to the topic of life insurance replacement that replacement regulation should be addressed as part of a broader consideration of the disclosure needs of the life insurance buying public, rather than as a separate issue to be judged as "good" or "bad" for the policyholder. The Committee will address in detail the topic of a disclosure system for sale of life insurance in Chapter 9 of this Report.

In regard to the replacement situation as well as to all original solicitation situations, it is the Committee's conclusion that the responsibility for providing appropriate information to the policyholder or prospective policyholder should fall on the insurance company and that the agent might share in that responsibility but should not be deemed to assume the responsibility in lieu of the insurer.



In regard to the concern of insurance companies that they be given the opportunity to conserve their existing policies, the Committee repeats its suggestion made under the topic of lapsation, that insurers institute quick-response notification procedures, applicable to all situations of policy termination, informing consumers of the consequences of early lapse or surrender of a policy. The Committee believes such procedures are in the interests of all life insurers and that regulations in this regard are not required.

- 4.18 To protect consumers in situations of policy replacement by permitting them time to consider the reasons for retaining their existing policies, the Committee recommends that the Superintendent give consideration to the need for requiring that insurers provide a 20-day period within which replacement policies can be terminated with full refund of premiums.

This 20-day money-back period need only be applicable in replacement situations, and would need to be brought to the consumer's attention in point-of-sale disclosure material.

- 4.19 It is the Committee's further recommendation that the offence of "twisting" as a separate offence under Section 357 of Part XIV of The Insurance Act should be withdrawn from that Part of the Act.

In the absence of Section 357 of the Act, the Committee recommends that the Superintendent's authority to take action with respect to misleading representations, incomplete comparisons or coercion to purchase a policy of life insurance, be reinforced by amendments to Part XVIII of the Act to include in clear terms such acts or practices as "unfair or deceptive". In this same regard, the Committee points out that the Superintendent is already able to examine and investigate, under Section 388(b)(vi), situations involving "any incomplete comparison of any policy or contract of insurance with that of any other insurer for the purpose of inducing, or intending to induce, an insured to lapse, forfeit or surrender a policy or contract".

## **9. Problems that Arise with Respect to Special Claims Situations Should be Reviewed**

The Committee has examined briefly the practices for settlement of life insurance claims, with the following conclusions.

- 4.20 The Committee urges the life insurance industry to continue improving its practices with respect to reducing delay and paying interest on claims when delay occurs, in *all* claims situations, including claims under policy riders and claims for the cash surrender value of the policy.
- 4.21 The Committee urges the life insurance industry and the Superintendent to cooperate in a review of the special problems that arise in re-

spect to a claim under circumstances of disappearance or difficulty in establishing death. The Committee believes that standard practices should be developed in dealing with such claims situations, and that these practices should be enforced by the Office of the Superintendent, if necessary.



## CHAPTER 5

### Annuities and Individual Retirement Plans

#### A. INTRODUCTION

The previous Chapter addressed the topic of life insurance products which provide death benefits. This Chapter turns to discussion of annuity products. The annuity side of the life insurance industry's business is concerned with income paid to the policyholder during his lifetime.

Life insurance companies have been selling annuities for over 200 years. In 1978, thirty-four percent of benefit payments made by life insurance companies in Canada were in the form of annuity payments. The amount paid out was close to one billion dollars. The size of the annuity business in Canada requires that it be given significant consideration in any investigation of the life insurance industry.

The importance of annuities is magnified when it is recognized that annuities are part of a larger retirement or pension income system. This, however, complicates the study of annuities as broad issues of retirement income planning affect the business of insurers and yet the insurance industry is but one of several participants in the retirement and pension income field.

This Chapter addresses the topic of annuities under the following headings:

- Individual Annuities
- Retirement Savings Plans

The purchasers of annuities include both individuals and representatives of groups, in particular, employers. Group annuities purchased with some or all employer contribution are better known as pensions. The subject of pensions will be dealt with in the next Chapter. The main focus of this Chapter will be on individual annuities and on individual registered retirement savings plans.

While the discussion in this Chapter focuses primarily on the types of annuity products made available to individuals, most comments apply equally to all types of annuity products, whether they are meant for individuals or groups, or for registered or non-registered retirement savings purposes.

#### B. INDIVIDUAL ANNUITIES

##### 1. What are Annuities

###### *A Stream of Income*

Annuities are contracts that promise individuals payment of a stream of



income. Annuity contracts are concerned primarily with payout of funds. The payout might be spread for a specified period, such as ten years, or for as long as the annuitant lives.

The distinction between life annuities and term certain annuities is fundamental to understanding the involvement of life insurance companies in the annuity business. To the extent that payouts are contingent on the survival of one or more lives, an annuity contract is known as a life annuity and is readily seen to be part of the business of "life insurance". Under a life annuity, income is paid for as long as the annuitant lives no matter how long that may be. A contract which provides regular income payments for a specified term of years is known as a term certain annuity. It is not really an annuity contract in the sense that it is not related to life contingency in any way. Term certain annuities are sold by life insurers and by financial institutions other than life insurance companies.

### *Funding an Annuity*

A further distinction must be made in describing annuity products, that being the distinction between "pay-in" and "payout". An annuity is primarily concerned with payout of an income stream. A pay-in or funding element can be integrated into an annuity contract to facilitate purchase of an annuity income stream.

Purchasers can fund an annuity contract with a single, lump sum premium or pay in premiums over a period of years. Premiums can be fixed and level or can be flexible as to amount and timing of contributions.

Under an immediate annuity policy, where payouts begin immediately, the annuity contract is funded by a single lump sum payment. Under a deferred annuity contract, where payouts are deferred until some future year determined by the buyer, the annuity contract can be funded by either a single premium or by premiums contributed up to the date of maturity when payout starts. Until the payouts begin, the individual's premiums and the income they generate are invested for him by the insurance company.

### *Tangible Product*

Annuities and, in particular, immediate annuities, are more tangible a product than is life insurance. For example, payments under annuity contracts are made to the policyholder during his lifetime and not to a third party upon the death of the insured as in life insurance. Furthermore, the starting date for payment is prespecified and not contingent upon a death. In the case of immediate annuities, benefits under the contract begin immediately rather than at some unforeseen time in the future.

The more tangible nature of annuity products would appear to be favourable to a competitive situation in the annuity market. It could be ex-

pected as well that sales of annuities are more often buyer-initiated than is the case for life insurance policies.

## **2. The Purpose of Annuities**

### *Income Security*

Annuities serve principally as a means of income management, particularly during retirement; that is, as individual pensions. In the case of life annuities, they provide the principal advantage that an income stream can be guaranteed over the lifetime of the annuitant, with none of the care or worry associated with other investments.

Until payouts begin, investments add to the pool of capital out of which income is paid. Even over the period of payout, investment income is added to the capital pool, but on a declining basis. The rate at which investments increase the size of the pool varies, depending on whether the annuity is *fixed*, with a guaranteed minimum rate of return, or *variable* with no such guarantee.

Fixed annuities are the most secure type of annuity; they guarantee a fixed level stream of benefits over the term chosen by the policyholder. For example, under a fixed life annuity, a level stream of benefits is paid for as long as the annuitant lives. Beneficiary provisions provide for a quick and simple transfer of funds to a specific person or persons.

With the purchase of a fixed annuity, the policyholder is insulated from interest rate fluctuations. The guarantee that he receives of a fixed income stream is the safest form of investment available to him. There is absolutely no worry, personal management, reinvestment decisions or risk for the annuitant. Investor losses on annuities with insurance companies are unheard of.

However, a fixed annuity does not protect the annuitant from the effects of inflation. Contributions to a fixed annuity are typically invested in long-term bonds, so that the policyholder does not get much benefit from shorter-term increases in interest rates. On payout, payments are fixed over the annuitant's lifetime, based on the amount built up at the end of the accumulation period.

An alternative option is the purchase of a variable annuity. The variable annuity responds to short-term changes in interest rates. To the extent that rates of return on such investments as stocks, bonds and mortgages are related to changes in the cost of living, the variable annuity increases or decreases the amount of income to be paid. The payout amount is not guaranteed since it depends on interest rates at maturity. With the availability of both fixed and variable annuities, life insurance companies provide for a range of income security needs among individuals.

## *The Secondary Purpose of Annuities*

As a secondary advantage, annuities provide for the deferral of income tax on interest accumulating on savings in the annuity fund. Annuities receive favourable tax treatment in a number of ways. First, until payments start, all of the investment income earned on the initial and periodic contributions compounds tax free during the accumulation period. Secondly, the tax that accrues once payout of income begins is lessened in impact because the payout of investment earnings and capital in an annuity is prorated over a period of time or until death. While income tax must be paid on the portion of each year's income related to investment of the original contributions, the tax effect is lessened if the payout begins when normal income drops, as at retirement. The capital portion remains tax-free and the taxable portion qualifies for either the \$1,000 interest deduction or the \$1,000 pension deduction after age 65. Third, special rules for deferment of income tax by the spreading of personal income over time apply in two specific instances, through the purchase of income averaging annuities (IAACs) in the case of receipt of extraordinary income and through participation in registered retirement savings plans (RRSPs) with related annuity options.

The current major stimulus for the use of individual annuities has been the favourable tax treatment given to income averaging annuities and registered retirement savings plans. The role of annuities in the market for registered retirement savings plans (RRSPs) will be developed in some detail following a more general discussion of the annuity business of life insurance companies. It is noteworthy here that the tax deferral features of annuities and the requirement for an annuity option under RRSP plans serve to encourage buyer-initiated sales in contrast to life insurance which "has to be sold".

### **3. The Annuity Business of Life Insurance Companies**

Despite the utility of annuity contracts in providing lifetime income, it was not until the early 1970's, when the tax deferral advantages of registered retirement savings plans were increased and widely publicized, that individual annuities began to become a major segment of the business of life insurers. Over recent years, many new products have been developed to service a dramatically expanding annuity market. Noteworthy is the development of a wide array of options in the payout of income and the introduction of flexible premium annuities which provide the policyholder with considerable freedom as to the amount and timing of contributions. As a result of these developments, growth in the annuity business has been rapid.

During 1978, Canadians paid \$1,066 million in individual annuity premiums and purchases, compared to \$126 million in 1970. In 1978, a further \$65 million of life insurance policy proceeds were used to establish settlement annuities. Of the total premium income in 1978 of life insurers doing

business in Canada, individual annuities accounted for 21.2 percent, compared to 6.7 percent in 1970.

Individual annuities have also grown in relation to group annuities. Throughout the 1960's, group annuities used in pension plans accounted for about 75 to 80 percent of total annuity premiums. By 1978, however, individual annuities accounted for 47 percent of annuity premium income.

It should be noted as well that in 1978, for the first time, annuity payments both on individual and group contracts totalled \$991 million and thus exceeded death claims at \$909 million. Only 4 percent, or some \$39 million, of annuity payments were made from segregated funds.

There is little information to indicate the number of annuity contracts at the payout stage and the number of deferred annuity contracts at the accumulation stage in existence at the present time. As seen in Table 1 below, a LIMRA survey of 39 life insurance companies selling fixed annuities in Canada indicates a greater flow of funds into immediate than into deferred annuities, in that 52 percent of new premiums collected by these companies in 1978 were used for purchase of a contract with immediate payout. However, immediate annuity contracts represent only 17 percent of new contracts issued.

**TABLE 1**  
**INDIVIDUAL FIXED ANNUITY SALES OF LIFE INSURANCE COMPANIES—1978**  
(Survey of 39 companies doing business in Canada)

	New Premiums		New Contracts	
	\$ Million	%	Number	%
<b>Immediate Annuities</b>	\$335.3	52.4	14,775	17.2
<b>Deferred Annuities</b>				
Single Premium	\$136.3	21.3	18,194	21.2
Periodic Level Premium	9.6	1.5	15,033	17.5
Flexible Premium	<u>158.3</u>	<u>24.8</u>	<u>37,929</u>	<u>44.1</u>
<b>Total</b>	<u>639.5</u>	<u>100.0</u>	<u>85,931</u>	<u>100.0</u>

Source: LIMRA, "Individual Fixed Annuity Sales in Canada".

Deferred annuities account for less than one half of new premiums collected but for close to two in every three new contracts issued. Flexible premium contracts are most popular but are reported by LIMRA to be levelling off in growth. Only 1.5 percent of annuity premium income was received in the form of level periodic payments. This appears to indicate that purchasers of deferred annuities prefer to save for or contribute to their annuity purchases in ways other than through a rigid system of fixed contributions.

No data are available on annuities by payout type.



On average, just over one half of the annuity sales of the companies surveyed were registered as RRSPs. As a result, a great deal of annuity product innovation is aimed at competition in the RRSP market. While the sale of registered plans is showing strong growth, so are sales of non-registered plans, particularly of the single-premium type. Income averaging annuities or IAACs are a major factor in the non-registered segment of the annuity market.

#### 4. Definition of Annuities

The definition of life insurance in The Insurance Act is such:

“life insurance” means insurance whereby an insurer undertakes to pay insurance money,

- (a) on death; or
- (b) on the happening of an event or contingency dependent on human life; or
- (c) at a fixed or determinable future time; or
- (d) for a term dependent on human life,

and, without restricting the generality of the foregoing, includes accidental death insurance but not accident insurance;

“insurance money” means the amount payable by an insurer under a contract, and includes all benefits, surplus, profits, dividends, bonuses, and annuities payable under the contract;

This definition clearly seems to include annuities. However, two recent court decisions in Western Canada, where it was ruled that an annuity is not life insurance, have created a great amount of confusion. In these cases, it was held that the uniform definition of “life insurance” does not include annuities. The Superintendent of Insurance in Ontario is studying the matter to revise the definition so as to leave no ambiguity in the definition insofar as annuities are concerned. The CLIA has also indicated to the Committee that this matter requires early resolution in legislation.

As favourable tax treatment is accorded to annuity products, a clearer definition of the term is required and is provided for in The Income Tax Act and in the rules and regulations of Revenue Canada. In other words, at the present time, the practical definition of what constitutes the business of annuities is found in income tax legislation and regulation and not in The Insurance Act.

A “life annuity contract” is defined under the regulations to The Income Tax Act, as such:

“A life annuity contract means any contract under which an insurer of annuities, authorized to do so by Canadian federal and provincial laws, agrees to pay an annuity to the individual (“annuitant”) solely, or to

two or more annuitants jointly. The annuity instalments must be equal in amount; be paid annually or more frequently; commence on a specified day; and continue throughout the lifetime of the annuitants or one or more of the annuitants.”

This definition rules out variable contracts in which income payments may not be equal in amount.

If an annuity contract or any separate agreement that deals with the contract provides for payout options other than those of a life annuity, it is not regarded as a non-taxable *life* annuity contract, that is, if it contains any of the following options:

- an annuity certain
- cash withdrawals, in total or in instalments until proceeds are exhausted
- proceeds left on deposit.

Conversely, any “contract” issued by licensed insurers with other than the above options can be designated to be a life annuity contract if a single life or joint life annuity option is attached.

Relevant to later discussion is the point that if the policyholder wants something other than a life annuity, it would be simple for him to buy a *deferred* life annuity in standard form but redeem or cash in his policy prior to the date at which options are to be exercised. Any income earned on his premium contributions would, of course, be taxable at that time but it would not have been taxable over the period of accumulation. As a result, the policyholder could have used the deferred annuity contract as a tax-deferred savings plan. In the case of a registered plan only, if the proceeds of terminating a deferred annuity are “rolled over” into another registered retirement plan, the tax deferral advantages of the old contract are carried over into the new contract.

## **5. The Life Annuity**

### *The Principles of a Life Annuity*

Life annuities are sold only by licensed life insurance companies.

With the purchase of a life annuity, one contributes to a pool of capital. Investments of that capital add to the pool of funds. Insurance principles then determine the distribution of funds. If the people in the pool live longer than mortality tables say they should, the insurance company has to use some of the money out of the pool to continue payments for as long as they live. If the people in the pool die sooner than the mortality table says they should, the insurance company keeps some of their capital to use for others in the pool.

Recognizing the specialized service of providing guarantees for life,

the government long ago made arrangements to protect the long-term interest of the public by requiring insurance companies to establish and maintain minimum financial reserves for each life annuity. If other institutions were allowed to issue life annuities, and if their annuities were to provide the same security, similar reserves would have to be maintained. These companies, therefore, would also need to develop systems to analyze mortality, investment and expense factors for life annuities.

Even then, banks and trust companies would face greater financial risks than life insurance companies. This is because potential increases in longevity, while posing a financial hazard to those who issue only life annuities, are of beneficial effect for the life insurance business. That is, the adverse effect of increases in mortality on one side of a life insurer's operations is usually compensated by the fact that insured lives will also have experienced improved longevity, thus deferring payments of death benefits under insurance contracts. Since banks and trust companies would not be issuing life insurance, they would not have this beneficial effect to compensate for the adverse financial effects of greater longevity among annuitants.

### *Life Annuities with a Guaranteed Period*

A life annuity pays income throughout the lifetime of one or more annuitants. No further payments are made to anyone after the annuitants' death. This type of policy provides the largest amount of lifetime income per dollar of purchase money.

In the purchase of a life annuity, there is the chance that an annuitant may be one of those who die early and whose capital will be used to pay the other, long-lived annuitants. In such situations, it is difficult to determine the actual, total return to any one policyholder. The return can only be calculated for a normal or average life.

It has been said that people who buy life annuities "forfeit" their capital to a life insurance company. Purchase of a life annuity with a guaranteed period or purchase of a term certain annuity are recommended as means of protecting investment in an annuity. Various types of guarantees of payments to beneficiaries are available as options to a life annuity but guaranteed benefit periods cannot be less than ten years. In such contracts, capital is divided not only among the annuitants but also among the survivors of annuitants who die early, before the end of the guaranteed period. Since more people share in the capital under a guaranteed period contract, each payment is made smaller.

Thus, while the addition of a guaranteed period assists in defining the amount of return on the funds put into an annuity, it lowers the amount of monthly income. If a person lives beyond the guaranteed period his return on a guaranteed period contract will be lower than on a "pure" life contract. Given the uncertainty of the time of death, these two policies cannot be compared directly, on the basis of monthly payments.

An important competing product is a joint life and last survivor annuity, based on the lives of two or more people. It provides annuity benefits until the death of the last survivor of two or more annuitants. Again, each payment is smaller than under a single life annuity, as payments are made for the duration of two lives.

Choice of a life annuity, a life annuity with a guaranteed period, or a joint life and last survivor annuity is a matter which does not lend itself to any objective conclusions as to which should be favoured by a given purchaser. As with the choice of life insurance products, the purchase decision must rest upon the nature of the consumer's needs for spreading his income over time and his personal opinions about how best to assure the future availability of funds.

### *Underwriting the Life Annuity*

An applicant who has reason to believe that his longevity is impaired may seek life insurance. The opposite is true in the case of life annuities: people are unlikely to exchange their capital for a life annuity unless they feel fairly sure of enjoying a longer than average lifespan. The risk of life insurers is that annuitants will outlive their capital.

In the sale of life insurance, insurers screen and isolate substandard risks so as to price their products on the basis of normal lives. In contrast, when a person comes in to buy an annuity there are generally no health, occupation or avocation questions asked, with these exceptions:

- A few companies require the agent to indicate if the annuitant appears to enjoy reasonably good physical and mental health, primarily as a precautionary measure that protects the applicant as well as the insurer against misunderstandings about the purpose of the annuity.
- Another exception in regard to eligibility arises with those persons having attained a maximum age which some companies impose as a limit on the sale of annuities. Maximums vary from age 70 to 90 and over.

Other than with these exceptions, all applicants for an annuity are accepted.

Whereas age at purchase is a negative factor in buying life insurance, being associated with increased premium costs, it is a positive factor in the sale of annuities. For a given amount invested in an annuity, the amount received in monthly payments can be increased by delaying the age at which the annuitant starts to receive payments. Furthermore an annuity contract need not be bought at an early age to guarantee coverage as is done in life insurance sales.

In determining rates for annuities, actuaries use either a specific mortality table based on annuity experience or make an adjustment to life insurance mortality tables. The adjustment results in a lower mortality applied to



annuity rates in order to provide the insurer with a margin of capital in case life expectancy increases in the future. As noted earlier, the risk to a life insurer is that annuitants will outlive their capital, thereby increasing the company's obligations.

For these same reasons an adjustment in income stream is made between males and females. As females outlive males on average, a lower payout is provided by most companies to female annuitants than to males for the same amount of premium contribution. In group annuity situations, employers must contribute more on female lives if they wish to provide equivalent amounts of pension to both male and female employees.

There is no industry-wide consistency in interpreting and applying mortality statistics in rating annuity risks.

Noteworthy also is the treatment of applicants with a demonstrably short life expectancy. Favourable terms for the purchase of annuities may be granted in the case of severe impediments which lessen life expectancy and the risk to insurers. If an annuitant's life expectancy is short, payments can be made much higher by "rating up the age"—in other words, charging a premium for an age greater than the true age. Those companies who sell substandard annuities in which the amount of monthly payments is increased require that the applicant present a medical certificate indicating a permanent and major health impairment. However, due to the difficulty of verifying a possibly exaggerated impediment, this is not frequently done.

A 1977 CLIA survey of underwriting practices found that substandard annuity policies are issued fairly infrequently even among the 40% of the largest companies surveyed and 10% of the smaller companies who said that they would increase income because of the impaired health of the annuitant.

Those companies writing substandard annuities sometimes impose an additional policy fee for evaluation of the substandard risk. Some companies also insist on a guaranteed period of 5 or 10 years or an instalment refund provision to avoid criticism of the next of kin in case of early death. Rated annuities are typically sold only on a single-premium, immediate basis.

It has been suggested that with more Canadians buying registered retirement savings plan, it is no longer true that only those who expect to live longer buy life annuities. Therefore it is argued that the need to charge less for annuities on impaired lives should be given greater consideration by life insurers, or might be made mandatory in some situations.

The CLIA suggests an alternative solution in the case of RRSPs. It suggests that tax rules be amended to allow persons with impaired health to buy an annuity certain rather than a life annuity. In this way the term of the annuity can be matched to an approximation of the life expectancy of the annuitant.

## *Participating Annuities*

A common criticism of life annuities is their invariability in payout once payments have begun. That is, payments are generally equal or level and do not respond to changes in the income needs of the individual or to inflation. This is largely due to income tax regulations, outlined earlier, which require that life annuities and IAACs provide *equal* annuity payments.

There is, however, increasing interest and demand for more variability in payout of annuities. When interest rates must be guaranteed over a long time to provide a stream of level income payments, they are bound to be conservative. In addition, as the value of benefits is fixed in nominal terms, inflation eats into the purchasing power of benefits.

One means by which variability can be introduced into payouts is through the vehicle of a *participating annuity*. Dividends and interest on such dividends can be used to increase the amount of an annuity and are allowed under tax rules as an addition to the tax-free capital element of an annuity.

For the most part, annuities in Canada have been non-participating, that is, refunds to policyholders based on favourable investment, mortality and operating experience of the insurance company have generally not been provided, although some such annuities are available. In 1978, 21 percent of premium income in individual annuity business represented participating policies. It is noteworthy that certain U.S. based mutual companies provide only participating annuities.

While it has been suggested that, as a means of providing an increasing income, dividends could be used to buy additional paid up amounts of annuity, it has been argued in the past that the annual increases in annuity amounts could be so small that they may not warrant the cost of this program. However, computerized recording of transactions makes this type of program more feasible now than it was in the past.

There is no reason in theory why dividends should not be paid. The dominating factor that would produce surplus is interest. However, many insurance companies in their deferred annuity contracts have preferred to introduce flexible premium annuities with periodic readjustments of interest guarantees rather than meet changing investment conditions with participating annuity products. They argue that participating annuities would be non-competitive because lower interest guarantees would be given initially compared to non-participating products.

In the case of immediate annuities also, insurers perceive certain difficulties with dividend payments. Once annuity payments have begun, the trend in dividend payments, were they to be provided, would be for decreasing refunds each year. Each year as annuity payments are made, a part of the capital in the annuity fund is returned to the annuitant so that the base upon

which interest is earned decreases. Hence dividend payments based on surplus interest earnings diminish each year. This is perceived to be a negative trend by life insurers. In addition to interest adjustments, adjustments based on experience in other factors, in particular mortality, are made on par policies. As a result, lower mortality experience than that assumed when the annuity was bought may create a loss to the company and cause dividends to be decreased. These factors discourage many insurers from offering participating annuities, although the dividends based on investment experience could still be to the benefit of the annuitant, especially in the early years of annuity payout.

Introduction of variability into annuity payout is of increasing interest particularly in annuities sold as part of retirement savings plans. As discussed later in this chapter, the life insurance industry is the sole provider of life annuities for retirement purposes and should perhaps be called upon to introduce innovative approaches to the payout of lifetime income.

### *Efficiency of Life Insurance Operations*

In the area of life annuities, insurance companies compete only amongst themselves as no other financial institutions are permitted to issue life annuities. Term certain annuities, even with a term certain to age 90 do not provide the full guarantee of income available for as long as the annuitant lives and hence institutions selling these products compete only indirectly with life insurance companies in at least part of the annuity market.

As the only industry providing life annuities, it would seem the life insurance industry should assume the responsibility of demonstrating efficiency as well as responsiveness to consumer needs. The importance of efficiency is magnified by the exclusive role played by insurers in providing for the life annuity option under RRSP rules.

## **6. Immediate Annuities**

A monthly, quarterly, semi-annual or annual income stream bought with a single lump sum payment and payable within a year after purchase is known as an immediate annuity. Immediate annuities can be either life annuities or term certain annuities.

Immediate annuities serve a number of purposes. They may be the means of providing for income payout from a registered retirement savings plan or other non-registered savings plan. A single-premium immediate annuity may be an income-averaging annuity contract (IAAC) which has the effect of spreading over future years the income tax liability that would otherwise arise immediately on receipt of certain "special or extraordinary income". The regulations governing the specific requirements for tax deferral under RRSP annuities and IAAC's are lengthy and beyond the scope of the Committee's study.



Some companies,<sup>1</sup> before issuing an immediate annuity, require a "statement of understanding" to be signed by the applicant in certain circumstances. These circumstances include advanced age, doubts as to competence and absence of term certain, but there is little consistency in the factors triggering this requirement. This measure is a means of protecting both insurer and applicant.

In addition, many companies<sup>2</sup> require an agent writing a single-premium immediate annuity to state the source of funds.

### *Rate of Return*

The amount of monthly or annual benefits payable under an annuity is determined in large part by the interest earned on the principal remaining in the annuity fund. For a "fixed" annuity, this rate of interest is guaranteed or may be reflected in a guaranteed amount of benefits. Competition for annuity business, both among life insurers and trust companies who sell specified term certain (other than life) annuities, has ensured that immediate annuity contracts are tied closely into prevailing rates of interest in financial markets. As a result quotes on rate of return or on an amount of periodic benefits for new contracts may change daily, weekly or as often as needed to reflect changes in the general level of interest rates. It has been found, however, that the rates of interest applied to immediate annuities are some 2 to 3 percentage points below rates paid by banks and trust companies on their savings accounts. The reduced rate of interest is accounted for by charges made by insurers for setting up an annuity stream of income.

Considerable variability exists among companies in the guarantee or promise of future benefits of life annuities, but not only for reasons of differing interest rate assumptions. Insurers also take into account varying mortality assumptions and expense experience and cash needs in the pricing of their annuity products as noted in the following comment:

"The reason for differing (annuity) values is not the inequity of insurance companies but differences between their morality experience and investment results. Add to this fact that the market is perpetually changing. There is never uniformity of rates among insurance companies. Mortality varies because of such things as the agency arrangements, the geographic and occupational spread of policyholders. The interest rate depends on the investment strategy and the skill with which it is carried out.

The cash needs of insurance companies vary greatly from time to time and cash needs dictate competitive standards. Another factor in making

1. CLIA, "Underwriting Practices Survey", 1977.

2. *Ibid.*



comparisons is that some companies specialize in certain types of annuity and consequently may offer a larger return while others will quote but are not seriously in the business.”<sup>1</sup>

As a result of all these factors the Committee has seen evidence of substantial differences in quotations of annuity returns among life insurers competing for new contracts. Yet, once an immediate annuity is bought, the choice made is firm and final. Therefore it is evident that the consumer should shop around if he is concerned about getting the greatest amount in benefits for the premiums he pays into an immediate annuity.

To accommodate the consumer's need for shopping around, a number of companies have gone into the business of regular polling of sellers of annuities for their current payout quotes. These “quotation specialists” provide their services directly to consumers or sometimes through life insurance agents. Agents need not use these services. It could, however, be to the disadvantage of consumers, not to request or require that a range of quotes be obtained by their agents or, alternatively, to deal with consultants in this field who will survey the market for annuities.

### *Commissions*

Commissions paid on sale of single-premium immediate annuities are low relative to commissions paid on life insurance products providing death benefits. Commission rates are said to vary from 0.5 to 4.0 percent of the amount of the single-premium contributions. It has been said that even these low-percentages are nevertheless too high a charge for larger amounts of investment in annuities.

It has also been argued that when RRSP policyholders are forced for tax reasons to buy a life annuity, it is inappropriate for representatives of life insurance companies to be paid a commission for the sale of such life annuities.

Life insurance companies argue that:<sup>2</sup>

- The fact that agents are paid by commissions rather than by other means makes little, if any, difference to the cost of annuities.
- The insurer's total charge against an annuity, for guarantees, sales expenses including commissions, administration expenses and profit are equivalent to a reduction in the interest rate of about 3/4 of 1 percent on immediate annuities. This compares favourably with charges made by other financial institutions for the services they offer. Hence, commis-

1. Robert Reid, “Choosing an Annuity”, *Canadian Risk Management and Business Insurance*, November-December, 1977.

2. Canadian Life Insurance Association, Submission to the Select Committee on Company Law, Appendix 9.

sion expenses are reasonable in amount and consumers still succeed in receiving a fair and reasonable return on their purchase.

- The applicant receives financial planning, tax planning and other advisory services, valuable to him in his annuity purchase. Therefore the commission is earned through services provided.

### *Rescission and Withdrawal Rights*

It is noteworthy that the CLIA has recommended to its member companies that they provide on individual guaranteed contracts, both life insurance and annuities, as a specific condition, a ten-day right of rescission with full refund of premiums. The purpose of this recommendation is such:

“Because the life insurance policy describes a complex legal agreement, it seems desirable that the policyholder should have a short time to study it, to get independent advice if he wishes and otherwise to consider what he has bought, with the privilege of cancelling his policy if he is not satisfied with it and reclaiming any premiums paid.”

The CLIA recommends that, for the above reasons, the rescission right be included in all new individual insurance and annuity policies, excluding single-premium policies. Exceptions might also be made for unregistered pension trust plans, variable policies, substandard policies and policies exceeding \$100,000 or some higher amount. Not all companies have adopted the CLIA rescission right guideline.

The specific exclusion of single-premium policies, which would include immediate annuities, single-premium deferred annuities, and single-premium adjustable whole life policies, is intended to prevent the movement of funds out of one contract into another because of changes in interest rate levels over the 10-day period after the policy is delivered. Because single-premium policies are tied into “new money” or prevailing rates of interest, they are vulnerable to being cancelled in this manner. At the same time, the consumer is made more vulnerable by the lack of rescission rights—he must make the right decision with no right to consider further what he has bought.

Once bought a term certain annuity can be cashed in; a life annuity cannot. That is, with a term certain annuity, the funds paid as a single premium are attributed wholly to the annuitant or his beneficiaries. It is then at the discretion of the issuing insurance company whether to permit in the contract the redemption or withdrawal of remaining funds once annuity payments have begun. Tax considerations may, however, restrict withdrawal privileges particularly with respect to registered retirement savings plans.

In the case of life annuities, the concept of contributions made to a pool of funds out of which payments are made requires that there will be no right

to withdraw funds once annuity payments have begun. Otherwise the balance between payments made to longer-lived annuitants and the excess contributions paid by shorter-lived annuitants could not be maintained. Therefore, the consumer is doubly vulnerable to making a correct decision in the purchase of a single-premium life annuity: he lacks a rescission right to cancel within 10-days of policy delivery and he lacks the ability to withdraw his funds once payments have started.

## **7. Deferred Annuities**

### *Types of Deferred Annuities*

Deferred annuities provide for a pay-in or funding period to facilitate purchase of an annuity option at some future point of time. That is, under a deferred annuity, income payments start at the end of some specified period of time or at a specific age. Deferred annuities can be quoted as commencing in a stated number of years, at a definite age, or as is now more common at any age from 50 to 71.

Deferred annuities can be purchased either by a single premium or by periodic premiums. The policy may call for equal annual premiums until the annuity commences or for a shorter period of time. Annuities funded by level premium payments no longer appear to be a major factor in new contract sales. In recent years, with the introduction of flexible premium annuities, the policyholder is allowed considerable flexibility as to the amount and timing of contributions. This mode of payment has become the most common for funding deferred annuities, especially when registered as retirement savings plans. The annuity income available for payout depends on the amount of contributions made over the deferred period.

Insurers sometimes market deferred annuities with the claim that, by the purchase of a deferred annuity, the consumer will avoid the policy fee for an immediate annuity. Such a fee is often payable when funds accumulated elsewhere are used as a single premium to purchase an immediate annuity. To some extent, this sort of claim can be misleading as the services of an insurance company are not provided gratuitously and the annuity holder must pay fees associated with policy issue and regular payout of income irrespective of the type of contract purchased.

It should be noted that in the event of the death of the policyholder before annuity payments begin, a death benefit is paid as a return of premiums or the cash surrender value of the deferred annuity contract if greater, but this benefit does not represent "life insurance". In addition, policy loans can be made upon the funds accumulating prior to maturity.

### *Cash Surrender or Redemption Values in Deferred Annuity Contracts*

Because an annuity does not offer a distinct benefit such as a face

amount of life insurance which must be funded from the premiums paid, the contributions accumulated in a deferred annuity belong to the annuitant, to be returned to him in the form of a promise of an income stream or, at his option before payments start, as a cash value. The amount of the cash value available at maturity of a deferred annuity and the surrender values available at interim periods of withdrawal of funds are important aspects of the annuity contract. As a result the concept of cash values arises in any discussion of annuities as it does in whole life insurance.

Cash values are based on the premium contributions made to a deferred annuity. As interest accumulates on the investment of the premium contributions, at some point in time the cash surrender or redemption value will exceed the premiums collected.

Calculation of both cash values and the monthly, quarterly or annual benefits that will be paid out under an annuity contract vary by company and depend on a number of factors:

- A life insurance company charges against the funds contributed into an annuity for the guarantee it provides of regular payments and for its sales and administration expenses and profits. These charges, if in the form of policy fees or a front-end load, reduce the policyholder's cash value and promise of income since they lower the capital available for investment. Alternatively, charges for expenses can be reflected in a reduced rate of interest to be paid on the annuity fund. The CLIA indicates that total charges are equivalent to a reduction in the interest rate of about  $\frac{3}{4}$  of one percent.
- Some insurers permit certain of their plans to be surrendered at any time prior to maturity for the premiums paid plus accumulated interest, as is typical in a savings plan. However a penalty, such as the loss of interest credited on premiums paid for some period of time preceding the date of surrender, or other such charges may be applied.
- The amount of cash value and the expected benefits to be paid will depend also on whether the investment performance of a group of assets is "segregated" from all other company assets in a separate fund or pooled with other assets. Segregated fund annuities are called variable annuities as described earlier in this chapter. They do not guarantee in advance an amount of monthly income, although typically they guarantee to return at least 75% of the premiums paid on maturity of the contract or prior death. At the maturity date, the current value of "units" acquired in the segregated fund determines the amount of life income or of cash values. So far less than 4% of total annual insurance premium income is invested by individuals in variable contracts, including both annuity and life insurance types.

These factors should be taken into account by consumers.



### *Deferred Annuities Viewed in Two Component Parts*

Deferred annuities were originally designed as a contract covering the terms of both accumulation and payout periods of time. In this way the guarantee of a rate of return on accumulated funds was matched with a guaranteed stream of income payout. Consumers buying annuities were buying foremost a guarantee of continual payments; the method of instalment contributions over a period of time simply facilitated this purchase.

Contracts are still written in this manner, to correspond to tax legislation, in particular to the definition of a life annuity in The Income Tax Act. However, in practice, both insurance companies and consumers may now be viewing the deferred annuity somewhat differently: that is, as consisting of two components—a savings or accumulation policy and a payout policy.

With the purchase of a deferred annuity, the policyholder has the option on the maturity date, before annuity payments start, of taking cash or converting the accumulated amount into a choice of one or more annuity options guaranteed in the contract. In electing to take the cash option, the annuitant can keep the funds or buy a new immediate annuity at the rates then current. That is, the consumer may elect to withdraw from the original deferred annuity contract at maturity and switch his funds into a new immediate annuity contract. It is generally to his advantage to do so at a time when interest rates on new contracts are high in comparison to the old contract guarantees.

In addition, in most deferred annuity contracts sold today, redemption privileges are provided which permit individuals to withdraw their funds before maturity without significant loss of premium contributions. Surrender of an annuity contract may, however, involve a withdrawal charge or redemption penalty, as noted earlier. It will also attract personal income tax on investment income earned over the “savings” period of the annuity. The existence of such penalties may discourage though not exclude surrender of the annuity contract. Both “penalty” factors should be clearly disclosed to the purchaser.

The option of withdrawing annuity funds at any point up to and at maturity is made available by life insurance companies selling annuities in order to compete with other financial institutions for the savings of Ontario consumers. Virtually all deferred annuities sold as registered retirement savings plans will in practice allow surrender of the contract with return of some amount of cash value. However, if the annuities are classed as life annuities, the Income Tax Act prohibits written provision for withdrawal of funds in the life annuity contract. Insurers nevertheless accommodate withdrawal up to the point of maturity on virtually all registered annuity plans. The proceeds of withdrawal from a registered deferred annuity contract can be “rolled over” into another registered retirement plan without attracting personal income tax.

For the most part, redeemable annuity plans are of the flexible premium type. Included also are single-premium deferred annuities which in any other circumstances are non-cashable; that is, insurers will cash in single-premium deferred annuities only if registered as RRSPs.

In summary, most life insurance companies today permit withdrawal of funds from deferred annuity contracts up to and at the date of maturity. The only category of annuity consistently viewed as non-cashable by life insurers is the single-premium, non-registered deferred annuity, accounting for perhaps 4-5 percent of new contracts written. While practices in regard to withdrawal privileges vary by company, most deferred contracts can be viewed as consisting of separate accumulation and payout components. As a result, prior to maturity, the annuity contract is much like a savings account.

### *Taxation Implications*

The treatment of deferred annuities as consisting of two components is of some concern to both insurance companies and to tax authorities. If in practice consumers treat a deferred annuity as a savings vehicle only and terminate the contract before payments begin, then it would seem appropriate that investment income earned over the accumulation period should be taxable as in the case of income earned on other forms of savings or investment. Insurance companies maintain the tax-free status of deferred annuities by insisting that the contract is meant to provide a stream of income. Under tax regulations, so long as a contract for accumulating funds contains one or more annuity payout options, it can be termed a deferred annuity.

The tax status of deferred annuities is of increasing importance because of the growing number of innovative annuity products which allow flexibility in contribution and withdrawal of annuity funds before maturity. These new products are taking over from traditional sales of fixed annuities, but they resemble ever more closely the savings instruments of deposit-taking institutions such as banks and trust companies. For example, a major insurer recently announced the introduction of a new annuity with values pegged to daily interest rates and with withdrawal privileges for all premiums plus interest thereon, subject to an interest penalty. The closer these products come to resembling savings vehicles, the more it is likely they will be used as such.

A recent development in tax treatment of cashed-in RRSP plans may also have some bearing on deferred annuity plans in general. The ability to cash in a deferred annuity during the accumulation period is not guaranteed in law but is subject to the discretion of individual life insurers. Most life insurance companies now voluntarily attribute guarantees of cash values to their deferred annuity products and stipulate the conditions of withdrawal, sometimes outside the terms of the contract. As already noted, redemption

privileges have become necessary on deferred contracts as purchasers of RRSP plans, a major market for deferred annuities, take for granted that they can cash in their plans at any time.

However, a recent ruling by the federal Department of Revenue may cause insurers to restrict or at least not commit themselves in any written form to the cashability of deferred annuities which are to be registered as RRSPs. The Department of Revenue has indicated "it would not accept for registration as a tax deferral vehicle any plan that gives an RRSP purchaser the right to commute (cash in) his plan in both the accumulation years and during the payout years. Any cashability right subsequently extended would cause the plan to become an amended plan at the time the right is given."<sup>1</sup> Once the plan is amended, it is deregistered and the tax shelter provisions of the Income Tax Act no longer apply. The intent of this ruling is to assure that income invested in an RRSP is actually meant for retirement purposes.

There are two implications of this latest tax ruling. First, the treatment of RRSP plans which are cashed in begs the question whether non-registered deferred annuity contracts which provide redemption privileges should also lose their tax deferral privileges. Second, to the extent this ruling discourages insurers from committing themselves in writing to withdrawal privileges, but does not stop the industry from permitting withdrawal in practice, problems of disclosure arise. That is, this ruling would appear to discourage disclosure of cash surrender values as primary privileges under the contract, although it might permit disclosure within the context of an amended plan or under different terminology such as "accumulation values". In any event, it could reduce the ability of the consumer to make correct purchase decisions as he may lack full information on cash surrender values and withdrawal privileges in general. Such consequences would not be to the public's best interests, in the opinion of this Committee.

The problems associated with tax treatment of deferred annuities will not be dealt with any further here, except to point out once again that the annuity business of life insurance companies has grown as a result of certain personal income tax policies in force in Canada today. The industry has as well evolved new products and practices to correspond to current tax rules and hence taken advantage of a market opportunity created by taxation legislation. To some extent, the industry's willingness to take up new market opportunities has led it away from products related strictly to life contingencies and towards products related largely to savings.

The Committee therefore feels it is necessary to recognize that life insurance companies are competing in the market for savings plans with other financial institutions. While this encourages efficiency and competition among the various savings institutions, it raises a problem for regulation of

1. *Globe and Mail* "RRSP buyer should examine its cashability", December 17, 1979.



the savings market. Whatever constitutes unfair or deceptive marketing practices in one sector of the market should do so in the other sector. At the present time, legislation is industry specific while consumer needs for information, fair advertising and consistency in price comparison are common no matter which industry is providing the savings plans consumers invest in.

### *Cost Comparison in Deferred Annuity Contracts*

Further commentary is required on the matter of cost comparison, in the context that life insurance companies compete in the market for savings plans with other financial institutions. As deferred annuity contracts prior to maturity are much like a savings account, a policyholder will want to know how much has accumulated in this "account" towards the payment of monthly income in the future.

Traditionally, with the sale of fixed level premium annuities, the policyholder was told the amount of monthly income or "annuity rent" which he would receive per \$1,000 of premiums contributed. With the switch to flexible premium annuities, he may now be told the annuity rate, or number of dollars per \$1,000 accumulated that will be paid out as monthly rent.

While this information is important to the annuity holder, it does not allow him to compare the amount and rate of accumulation under a deferred annuity contract with the amount and rate of cash accumulation in other methods of saving. If he is looking at the alternative of saving his money in a bank account, for example, and then buying an immediate annuity at a later date, he needs for comparison purposes information on the interest rate paid on the sums deposited into an annuity.

It is becoming increasingly common for life insurance companies in Canada to quote on annuity contracts on the basis of rate of return. This is not, however, a universal practice. Furthermore disclosure of rate of return is not standardized as to whether the rate applies to net or gross premiums paid. This leads to possible deception as will be discussed in reference to registered retirement savings plans. In addition some advertised rates of return are guaranteed for only the first 3 or 5 years and then guaranteed at a much lower rate in later years. This again leads to possible deception unless clearly identified in advertising.

In sum, the consumer needs more than a statement of guaranteed and current annuity payments to evaluate the cost of his annuity purchase. He requires as well disclosure of the rate of return on the sums deposited on an annuity. Only in this way can he determine how much has accumulated in his "account" toward payment of income in the future. However, he needs to know that the rate of return quoted to him fairly represents what cash will be available to fund annuity payout in the future. Hence it has been recommended in the United States, in the recent staff report to the Federal Trade Commission, that "disclosure of the average annual rate of return on gross



premiums paid'' be required for all annuity products.<sup>1</sup> Further comment on this matter is made in the discussion on RRSPs.

## **C. RETIREMENT SAVINGS PLANS**

### **1. Introduction**

This section expands upon the preceding discussion of annuity products by examining, in a broader sense, the role of the life insurance industry in providing individuals with the means of accumulating and periodically paying out income at retirement. The participation of the industry in private retirement planning is examined historically and, at the present time, primarily in regard to annuity contracts sold as registered retirement savings plans (RRSPs). Comments on current issues in the RRSP market and the role of the life insurance industry in resolving concerns conclude this section.

### **2. History of Saving for Retirement**

The necessity of retirement planning has always existed for individuals unable to rely on their family for support as they grow older and for those unable to rely completely on occupational pension plans or on anticipated benefits from government programs. Even so, individual saving for retirement is largely a recent phenomenon, arising from income levels high enough to support long-term savings and from a changing economic and social perspective on retirement. In particular, continuing increases in the standard of living are making a personal, supplementary fund for retirement income not merely desirable but essential.

As a perspective to recent developments, the early history of private or individual saving for retirement is traced in the following quote:

''Until the late 1920s, provision for old age remained primarily a matter of personal or family responsibility in Canada. Individuals were expected to save for their later years, and it was considered a family duty to support elderly relatives who were unable to work.

Apart from figures on annuities, there are no data indicating the extent to which Canadians saved for their old age, but it would appear that long-term saving in the forms familiar today were negligible. The development of a diversified institutional structure of financial markets capable of mobilizing and channeling the long-term savings of individuals into profitable investments is a relatively recent phenomenon in Canada.''

1. Staff Report to the Federal Trade Commission, ''Life Insurance Cost Disclosure'', June 1979, pg. 112.

“For many years, annuities issued by the insurance companies provided the principal means through which individuals could convert their modest savings into a stream of retirement income. This device developed only very slowly, however; by the end of 1910, less than 2,000 contracts were in force, two-thirds of them underwritten by a single company (Sun Life). In an attempt to fill the vacuum, the Government Annuities Act was introduced in 1908 to facilitate and encourage individuals of limited means to save for their old age. The Act allowed the federal government to sell small annuities to the public at rates that, at the time, were more favourable than those offered by private companies. Then, in 1919, the Income War Tax Act provided some stimulus to occupational plans by permitting the existing income tax deferment for employer contributions to be extended to cover employee contributions as well.

It was becoming increasingly apparent, however, that despite the foregoing legislative measure many individuals were unable to save enough to support themselves in their later years. Employer-sponsored pension plans expanded only slowly, with the number of formal plans growing from 172 at the end of the First World War to some 600 by 1936. Although there is no way of calculating what proportion of the labour force was covered by these plans, it has been suggested that it was in the neighbourhood of 10 to 15 percent . . . Furthermore, few Canadians took advantage of the opportunity to buy annuities from the government; less than 12,000 contracts for such annuities were in force at the end of March 1931, almost a quarter of a century after the Act came into effect. The annuity business of private insurance companies was even less impressive, amounting to little over 3,500 contracts in December 1930. Thus, although saving for old age was still considered to be largely a personal responsibility, it came to be recognized that some public support would be required for those who received little family support and those who failed to make sufficient provisions for themselves through occupational pension plans or personal saving.”<sup>1</sup>

Over the fifty years between 1930 and 1980, public pension plans and occupational plans have eased the burden of providing for old age which once was borne solely by individuals and families. At the same time financial institutions, among them life insurance companies, have expanded their services to facilitate the long-term saving of individuals. Although private institutions feared that the advent and growth of public pension plans would reduce the demand for private retirement plans, the market for private long-term savings has continued to expand.

1. Economic Council of Canada, “One in Three: Pensions for Canadians to 2030”, Appendix B, Ministry of Supply and Services, Canada, 1979.

Life insurance companies have in the past been active in the long-term savings market in a number of ways:

- Level premium deferred annuities enabled individuals to accumulate retirement funds and guarantee annuity income at retirement.
- Endowment policies which matured at a predetermined retirement age provided extra cash at a time when it was needed.
- Whole life insurance policies provided collateral for emergency borrowing or a cash surrender value if the insured was forced to cancel his life insurance policy for retirement income needs.
- Retirement income policies combined a retirement annuity with a life insurance feature. The death benefit paid was in the amount of the face value of insurance protection bought or the cash value whichever was greater. At retirement life insurance protection expired and a guaranteed annuity came into force. The retirement income policy is similar to an endowment policy at age 65 with a guaranteed annuity option.
- Other products combining life insurance protection with an income amount at retirement were also introduced.

It is difficult to estimate the extent to which policyholders have used life insurance products for retirement income purposes over the years. Although, today, two out of every three dollars paid out in payments by life companies go to living policyholders, there are no data indicating what proportion of total payments are used as retirement income.

Available data show that annuity payments have increased substantially in proportion of the total of benefits paid to living policyholders and it can be assumed that the majority of *annuity* income payments are for retirement needs. In contrast, payments on matured endowments which are readily identified with retirement income have since the early 1970s shown little growth. Voluntary terminations of policies may be associated with pre-arranged plans for retirement income but the extent of this usage has not been identified. The amount of surrenders increased in the 1950-1970 period, levelled off in the 1970-1975 period and increased once again during 1976-1978. It is likely that factors other than the need for retirement income are influencing surrenders of life insurance policies.

While the need for individual retirement planning has always existed, public interest has intensified during the 1970s. Numerous factors have precipitated increased public interest in saving and in insuring for income security at retirement, including:

- The realization that neither government social security programs nor occupational pension plans meet all income needs, combined with concern that inflation is eroding the purchasing power of these benefit schemes.
- Dramatic changes in the age profile of the Canadian population which

will result in a demographic imbalance of workers to non-workers. As a result self-support at retirement could become more critical in the future.

- Changes in taxation policy to broaden incentives for saving for retirement.

The latter factor has been most significant in expanding the market for private retirement saving. In 1957 the federal government introduced legislation to encourage private pension planning through Registered Retirement Savings Plans (RRSPs).

By March 1977, a survey commissioned by the Canadian Life Insurance Association to survey the attitudes of the Canadian public towards life insurance reported:

“RRSPs have developed strong support and are now seen as more desirable than life insurance, as far as planning for the future is concerned.”<sup>1</sup>

### 3. What is an RRSP?<sup>2</sup>

A “Registered Retirement Savings Plan” is first and foremost a personal pension plan which conforms to applicable legislation and regulations. It is a method by which individual Canadians can accumulate money now, and in future years, in order to build a continuing income during retirement. Canadians are encouraged and assisted in this accumulation of funds for retirement by opportunities for income tax deferral provided by government legislation.

#### *Early History*

The original purpose of RRSP legislation was the encouragement of private pensions, as indicated in the budget speech of the Minister of Finance in 1957 when the legislation was first introduced. His remarks made it clear that the fundamental concept of RRSPs was to allow persons who do not belong to employee pension plans to have the opportunity to accumulate a fund through tax deductible contributions which would be used to set up their own personal pension plans. It was also intended to enable members of employee pension plans to supplement their pension plan benefits within certain limits, in recognition of the fact that some employee pension plans do not provide as large a benefit as others. This legislation was introduced long before the inception of the Canada Pension Plan in 1966.

1. Centre De Recherches Contemporaines Limitee, “Data Base II, Attitudes of the Canadian Public Towards Life Insurance,” A Research Study Conducted for the CLIA, June 1977.

2. Much of this section is adapted from the submission made to the Committee by the Northern Life Insurance Company.



There was an advantage to the government in encouraging RRSPs, as well as all employee pension plans. The advantage was that the pensions ultimately provided during retirement by these plans would diminish the burden of responsibility on government to provide a satisfactory level of income security in old age. The Minister of Finance, in his 1957 budget speech, made it very clear that he was aware of the loss of substantial tax revenue on contributions to RRSPs but he felt that these plans made good sense as a means of promoting freedom from financial worry after retirement.

RRSPs were thus not intended to be simply savings plans, to be used by the participants as they saw fit. *They were designed with a definite social goal—the provision of retirement income.* To achieve this goal the government was willing to forego current tax income which, in effect, was contributed to the RRSP plan. Since the government was investing public tax dollars heavily in the accumulation by permitting tax deferment, it had the right of the obligation to the public to restrict the possible uses of the funds to those which would satisfy the goals of the legislation.

### *Participation by Life Insurance Companies*

In 1957, government annuities were the major investment vehicle for RRSP contributions. This investment vehicle declined in popularity over the next few years and by 1970 government annuities were not a major factor in the market. It was during this period, 1957 to 1970, that life insurance products became the primary investment vehicles for prospective annuitants.

This was a natural development in that the initial legislation and regulations for RRSPs clearly intended and provided that *the retirement pension be a life annuity.* In this way the pensioner would not run the risk of spending all his money before his death. The person could elect to have a guaranteed period built into the life annuity but only for a limited period. It was recognized that only life insurance companies were licensed to perform the specialized service of providing annuities guaranteed for life.

However, the government did not intend to restrict the *funding* of RRSPs before retirement exclusively to life insurance companies. Ample provision was made for an individual to use the services of other financial institutions for the accumulation of funds prior to retirement. In such cases, however, it was clearly established that the continuance of registration and the maximum benefit of tax deferral were subject to the requirement that the accumulated funds would be used for the purchase of a life annuity commencing not later than age 70.

In the early stages the existing products offered by the life insurance industry were used for RRSPs. Government regulations specifically provided

that any life insurance product other than term insurance could be registered and specific reference was made to the arrangements to register an already existing life insurance contract. Existing contracts had to be suitably amended to conform to the requirements of the legislation including such things as (a) requiring that the proceeds be used for a life annuity not later than age 70, (b) prohibiting borrowing against the security of the policy and (c) prohibiting assignment of the policy.

The registration of a life insurance policy enabled a person to have some life insurance in conjunction with an RRSP and it also provided for a premium waiver disability benefit which would complete the funding of the life policy and/or the RRSP in the event of the total and permanent disability of the policyholder. The government provided a formula for determining what part of the premium would be deemed to be the cost of insurance benefits and what part would be deductible as a contribution toward the funding of the ultimate pension.

The latest revisions to the Income Tax Act in respect of RRSPs were made in 1978. Further increases in contribution limits were included as well as the addition of new options for payout of retirement income.

#### 4. Growth in the RRSP Market

The growth of the RRSP market is illustrated in Table 2 which highlights the history of growth of new plan registrations and the total contributions made to 1978. 1978 figures are the most recent available.

TABLE 2  
REGISTERED RETIREMENT SAVINGS PLANS IN CANADA

Year*	New Registrations	Total Contributions (\$ million)
1960	17,475	28
1965	29,181	82
1970	76,983	225
1971	186,416	320
1972	301,418	645
1973	407,979	923
1974	419,186	1,224
1975	527,731	1,524
1976	701,999	2,116
1977	703,260	2,355
1978	713,874	2,400 <sup>c</sup>

Source: Revenue Canada, Taxation.

c = Estimate

\* Year ends on March 31 of following year.

TABLE 3  
REGISTERED RETIREMENT SAVINGS PLAN STATISTICS  
PERCENTAGE OF NEW REGISTRATION OF PLANS BY FINANCIAL INSTITUTIONS\*

Year**	Life Insurance Companies and Fraternal Societies	Trust Companies and Authorized Trustees	Corporations and Organizations Acting through Trust and Insurance Companies***	Corporations Approved by Orders in Council	Government Annuities
1960	33%	14%	20%	12%	20%
1965	30	33	19	10	7
1970	54	31	8	6	.3
1971	46	42	7	5	.1
1972	51	35	9	5	.07
1973	47	35	14	4	.04
1974	40	33	22	4	.02
1975	29	42	26	3	.008
1976	27	41	30	3	.006
1977	23	43	31	3	.005
1978	26	38	34	2	.002

\* Figures do not add exactly to 100% due to rounding.

\*\* Year ends on March 31 of the following year.

\*\*\* Principally Chartered Banks.

Source: Revenue Canada, Taxation

The growth of the RRSP market began with the enactment of enabling legislation in 1957. In the year 1960, the first for which reliable information is available, 17,475 plans were accepted for registration with total contributions of \$28 million.

By 1970, the total contributions made in the year had increased to \$225 million. It was during the eight year period from 1970 to 1978 that the most dramatic growth took place. New registrations increased nearly ten-fold to 713,874 while contributions made in the year had increased more than ten-fold to \$2.4 billion. Ninety life insurance companies and fraternal societies were reported to be selling RRSPs in Canada in 1978.

There were a number of reasons for the dramatic growth in both the number of new registrations and the dollars contributed:

- Maximum contribution limits were raised to \$4,000 in 1972 and then to \$5,500 in 1977. The change in limits caused increased activity particularly on the part of the trust companies and shortly thereafter on the part of chartered banks.
- Mass advertising by the trust companies and banks increased consumers' awareness of the advantages of RRSPs. A great deal of advertising was directed toward "immediate tax savings" rather than tax deferral and ultimate retirement income.
- Inflation greatly increased individual incomes while working wives increased family incomes, both factors creating more dollars for long-term savings.

As banks and trust companies became more aggressive in pursuing the RRSP market, the life insurance industry market share dropped from a high of 54% in 1970 to 26% of the market in 1978. As the life insurance industry share declined, the market share for trust companies and banks grew from 31% to 38% and 8% to 34% respectively between 1970 and 1978. Table 3 facing gives the percentage distribution of new plan registrations by financial institution from 1957 to 1978. It should be noted that some new plan registrations may involve the transfer of funds from a previous RRSP contract that has been terminated.

## **5. Life Insurance Industry Participation in the RRSP Market in 1977**

Further detail on the participation of the life insurance industry in the RRSP market is provided in Table 4 on the following page for the year ending December 31, 1977. Data for 1978 are not as yet available. As derived from Table 4, by the end of 1977 in Canada, 49,585 matured RRSP plans, paying annuity benefits, were in existence with life insurance companies. Eighteen times that number of annuity and other contracts or about 897,000 were held as active RRSP plans, not yet matured by way of purchase of a retirement income option.



**TABLE 4**  
**REGISTERED RETIREMENT SAVINGS PLAN STATISTICS**  
**FOR YEAR ENDING DECEMBER 31, 1977**

	Life Insurance Industry	Percent of Total
<b>1. Number of Active Plans</b>		
(a) Registered Plans—Annuities	342,512	38.2%
—DA or SF <sup>1</sup>	88,709	9.9
—Life or Endowment	402,277	44.8
—Other	<u>63,605</u>	<u>7.1</u>
	<u>897,103</u>	100.0%
(b) Amended Plans <sup>3</sup> prior to May 26, 1976	301	
<b>2. Number of Matured<sup>2</sup> Plans in Existence</b>		
(a) Registered Plans—Annuities Paid	49,107	
—No Annuities Paid	2,934	
(b) Amended Plans <sup>3</sup> prior to May 26, 1976		
—Annuities Paid	478	
—No Annuities Paid	10	
<b>3. Number of Active Plans Terminated</b>		
(a) Refund of premiums	4,413	
(b) Withdrawal of remaining funds (amend. plan)	9,498	
(c) Direct transfers	19,742	
(d) Purchase of annuity	<u>2,066</u>	
	35,719	
<b>4. Number of Plans Amended<sup>3</sup> After May 26, 1976</b>	17,282	

1. DA or SF is the short form for Deposit Administration and Segregated Funds.

2. Matured Plans: Plans mature by way of purchase of a retirement income option.

3. Deregistered plans with partial withdrawal of funds; these plans are still active until all funds are withdrawn:

Source: Canadian Life Insurance Association

Almost half of active plans in place at the end of 1977 were registered whole life insurance or endowment policies. Annuity products, excluding variable contracts, represented only 38 percent of active RRSP plans.

### *Group RRSPs*

It should be noted that insurance companies also offer group RRSPs. These are individual plans, although contributions are made through payroll deduction. The funds of all employees can be pooled into a common investment fund but, in most cases, an employee can choose from several investment alternatives.

Payroll deductions facilitate regular contributions and the tax department allows less tax to be withheld from pay cheques of those who contribute to a group RRSP, so that a tax refund is obtained immediately rather than waiting until a tax return is filed.

As the group RRSP is actually several individual plans, it solves the problem of pension portability. When an employee leaves he simply takes his share of the group RRSP with him. Should greater flexibility be introduced into RRSP plans in the future, then group RRSP plans may be favoured by the public over group pension plans which lock employees in. Insurers would be gaining by innovation in private pension plans but they could be losing corresponding sales in group pension business.

For the present, sales of group RRSP plans are still low. For the year ending March 31, 1978, only about 5% of new plans with insurance companies were group plans; this compares with 8% of new plans through trust companies.

## **6. Current Emphasis in RRSP Sales**

Two patterns have emerged in the RRSP market which are at odds with the original intention of the legislation. One is the heavy emphasis put on "immediate tax savings" and high rates of return which has led to short-term manoeuvres of money for non-retirement purposes. The other is the emphasis placed not only on freedom of choice in the methods of funding RRSPs prior to retirement but also on less restriction in the use of RRSP funds than is available with the original requirement for the purchase of a life annuity.

### *Competitive Aspects of RRSPs*

At the present time the market for funding of RRSPs exceeds the market for payout options on matured RRSP plans. As a result, competition is focused on "bringing money in". Advertising highlighting the immediate tax savings of RRSP plans is one aspect of the competition for the public's savings. At the same time new products are closely tied into the interest rates available on new investments, as RRSP savings must compete with other forms of investment income.

Nevertheless, RRSP legislation has been in effect for 23 years, so that many plans have entered into the maturity or payout stage where annuity options must be purchased. Competition at this stage has accordingly intensified, particularly as trust companies have been allowed to sell non-life annuity options, in competition with the range of annuity products sold by the life insurance industry. Annuity rates have also been forced to resemble closely the prevailing interest rates available on new investments. With prevailing rates at record high levels, the guaranteed rates on older, deferred annuity contracts may no longer seem favourable to annuitants.

### *Funding of RRSPs*

It is becoming increasingly common for consumers to regard the fund-

ing of RRSPs and the purchase of annuity options as two separate transactions.

There are a number of different financial institutions active in the RRSP market, providing a number of different funding vehicles, some of which are offered by more than one type of institution. Without defining these funding vehicles they can be summarized to include:

- life annuities or other products such as whole life policies, sold only by life insurance companies;
- equity funds, available from various sources including trust companies, banks, mutual fund companies, stock brokers and some life insurance companies;
- fixed income funds available as above;
- guaranteed investment certificates, used as a funding vehicle only by trust companies;
- self-administered RRSPs, usually but not exclusively established with trust companies;
- group RRSPs, administered by a trust company or an insurance company.

Of the traditional products sold by life insurance companies as funding vehicles, several have declined in acceptance. Innovations have arisen to meet changing public expectations for the funding of RRSPs and to meet competition. For example, registered whole life policies and deferred annuity contracts with fixed annual premiums have decreased in their share of new RRSP business. They provide long-term guarantees, but do not provide an adequate return in the case of whole life policies or do not have the flexibility to permit varying contributions from year to year. In some instances, however, flexibility has been provided in deferred annuity contracts by an option permitting contributions in varying amounts to be made in excess of the fixed level premium.

A specialized product developed for the RRSP market by the life insurance industry is the *flexible premium annuity*. Such plans provide true flexibility of premium to the extent that there is no contractual obligation to contribute a particular amount each year. The flexibility extends to the timing of contributions as well as to the amount. These plans provide interest guarantees at levels which reflect current market conditions and for periods of time which vary from plan to plan. They typically contain guaranteed rates for the provision of life annuities on retirement but make provision for the use of the company's then prevailing annuity rates if more favourable to the annuitant.

### *Payout Options*

In the 1978 revisions to RRSP legislation, the options allowed for payout of retirement income were expanded. The retirement income from an

RRSP must now begin not earlier than age 60 and not later than the end of the calendar year in which the person attains age 71. The retirement payout methods now include:

- Life annuities with or without a period certain and including joint and survivor annuities;
- Annuities certain to age 90;
- A Registered Retirement Income Fund (RRIF); and
- Various other non-level annuity payment systems, including (i) integration with Old Age Security, (ii) annuities indexed in relation to the Consumer Price Index, (iii) annuities with payments increasing annually at a specified rate not exceeding 4% per annum, (iv) “variable” annuities on which the payments increase or decrease in relation to the value of a specified group of assets maintained as a segregated fund for that purpose.

Retirement income options which are not contingent on life, such as annuities certain to age 90 and the Registered Retirement Income Fund (RRIF) option can now be purchased from trust companies. As a result the market for payout options has been broadened. However, the life annuity continues to be available exclusively from companies licensed to sell life insurance. Thus the life insurance industry remains a vital participant in the registered retirement savings market.

### *Current Sales of Annuities as Registered Plans*

With the widening of the RRSP market in the 1970s, the mix of products sold by life insurance companies for RRSP purposes has changed. Focusing on fixed annuity sales only, the traditional product sold by life insurers for retirement purposes was the level premium deferred annuity. The previous discussion has indicated a shift away from this product.

The most recent data on sales of annuity products as registered plans are provided by a LIMRA survey of 36 companies doing business in Canada. These 36 companies represent well over half of the sales of fixed annuity products sold by the 90 or so life insurers in the annuity market. Table 5 below shows the type of annuities sold by premium mode, for the year 1978.

Single-premium immediate annuities, which represent the purchase of a retirement income option on a matured RRSP plan, account for the greatest volume in new premiums paid to the insurers surveyed. However, in terms of number of new contracts, immediate annuities represent only a small proportion of sales, such that 87 percent of registered contracts are of the deferred type and 68 percent are deferred contracts funded over a period of time.



TABLE 5  
INDIVIDUAL FIXED ANNUITIES  
SOLD AS REGISTERED PLANS—1978  
(Survey of 36 companies doing business in Canada)

Premium Mode	New Contracts		New Premiums		Registered Plans as Percent of Total New Premiums
	Number	%	\$ Million	%	
Single Premium—Immediate	7,782	12.8	\$138.2	45.7	47.1%
Single Premium—Deferred	11,381	18.8	63.8	21.1	58.4
Periodic Level Premium	10,936	18.1	7.5	2.4	86.2
Flexible Premium	<u>30,436</u>	<u>50.3</u>	<u>93.1</u>	<u>30.8</u>	72.0
	<u>60,535</u>	<u>100.0</u>	<u>\$302.6</u>	<u>100.0</u>	54.1

Source: LIMRA, "Individual Fixed Annuity Sales in Canada".

In regard to the funding of deferred plans, flexible premium plans are the most popular, both in terms of number of contracts and premiums paid. It is noteworthy that the traditional level premium deferred annuity accounts on an annual basis for only 2.4 percent of new premiums coming in to the 36 insurance companies surveyed, although it still accounts for almost one in five contracts sold.

## 7. Current Issues with regard to RRSPs

The most critical issues facing retirement savings plans today are the concern that inflation will erode the purchasing power of RRSPs during retirement and the concern that inadequate explanation is often given about RRSP products. As a result of the first concern, suggestions have been made by many individuals and groups including The Consumers' Association of Canada that the payout options available to holders of matured RRSPs be revised, to encourage issuers of annuities to develop more flexible plans. In regard to the second concern, recent moves have been undertaken to improve the quality of disclosure and advertising related to RRSP plans.

While pension and RRSP legislation is outside the scope of the Committee's enquiry, the Committee is concerned with the way in which the life insurance industry is responding to private pension needs. That is, the Committee is interested in the way in which life insurance companies are conducting their business in markets established by pension legislation. The Committee is further interested in the steps undertaken by the life insurance industry to ensure to the greatest extent possible that current needs are being met, even if pension legislation has not yet caught up to needs.

In this content the Committee feels it is necessary to address the following topics:

- life insurance policies registered as RRSPs;

- development of plans with variable payout arrangements;
- consumer complaints;
- guidelines for advertising and disclosure of rate of return on RRSP plans.

### *Life Insurance Policies Registered as RRSPs*

Under RRSP legislation it has been possible for a policyholder to register any permanent life insurance policy, that is, not a term policy, and deduct the “savings” portion of the premium for tax purposes.

If the primary intent of an RRSP is to accumulate as much income as possible for retirement, by earning a competitive rate of return on premium contributions, savings through life insurance policies typically have not provided as good a rate of return as other methods of funding RRSPs. Moreover, the mixture of savings and insurance that occurs with registration of a permanent life insurance policy is confusing to the consumer in that it confounds his ability to determine what rate of return is being obtained on the retirement fund.

Conversely, registration of a life insurance policy interferes with the advantages of life insurance. On death, the deductible portion for RRSP purposes is fully taxed whereas there is not tax on a normal unregistered life insurance policy. On retirement, life insurance coverage must be given up, in order to start payment of retirement benefits. In the interim, the life insurance policy cannot be used as collateral for borrowing, as is possible if the policy is unregistered.

Other disadvantages of registration of life insurance policies as RRSPs include the inflexibility of contributions. The amount and timing of contributions can be varied under other RRSP funding vehicles. Under a life insurance policy, if required payments are not met, life insurance coverage is terminated or reduced by an automatic policy loan. Similarly, if the policy is “cashed in” to move RRSP funds to another funding vehicle, life insurance coverage is forfeited.

To caution consumers against these disadvantages, the CLIA has issued guidelines related to advertising and sales promotion of RRSP plans which state that advertising shall include:

“if describing a life insurance policy as suitable for registration, statements that (i) certain of its regular benefits are given up upon registration, and (ii) registered life insurance contracts may be more suitable as a means of long duration investment than short duration”.

A further guideline proposes that insurance companies review their portfolio of policies to determine which are suitable for RRSP purposes.

The Committee finds that the CLIA guidelines and, in particular, the latter guideline are somewhat ambiguous. The Committee is disappointed

that a stronger, more explicit guideline has not been developed by the CLIA, proposing that member companies clearly disclose that there are disadvantages to registering a life insurance policy as an RRSP plan.

### *Development of Plans with Variable Payout Arrangements*

Life insurance companies have the exclusive right to issue life annuities as one of three major options available at maturity of RRSP plans. The other two options are a fixed term annuity to age 90 and the registered retirement income fund (RRIF). Both the fixed term annuity and the RRIF have a major limitation in that they assume a person will live to age 90. The person living shorter or longer than to age 90 may be at a disadvantage relative to a person buying a life annuity. Many Canadians therefore find these options to be unattractive. As a result, life annuities are still an essential part of RRSP plans.

The main attraction of a RRIF as an RRSP option is that payments grow from year to year at the rate of return on investment in the fund. In other words, some flexibility is introduced into the payout of income in a way which protects the real value of benefits over time. This flexibility is lacking in life and, to some extent, in fixed term annuities.

The inability of the life insurance industry to introduce annuities, particularly life annuities, that are indexed to the cost of living or at least more flexible in payout, has been described by some as a critical failure of private industry to meet individual as well as group pension needs. Government involvement has been suggested, limited perhaps to the provision of indexed bonds or to an "inflation insurance" scheme.<sup>1</sup> In this way, insurance companies could issue indexed annuities based on holdings of indexed bonds or backed by the government inflation insurance program.

The Committee shares the concern that innovation is required in the payout of annuity income for retirement purposes. Life insurers have adapted readily to competition with other financial institutions in providing new options for the funding of RRSP plans. In the matter of payout on life annuities, significant efforts at innovation are also required.

One proposal for innovation with respect to retirement income payout is outlined below. The Committee includes review of this proposal in its Report in order to bring to the industry's attention the need for life annuities that do not erode in value with inflation. Another proposal, that of participating annuities over the payout period was discussed earlier in this chapter and the Committee urges the industry to examine ways of making participating annuities more attractive to both consumers and insurers.

1. Economic Council of Canada, "One in Three: Pensions for Canadians to 2030", Ministry of Supply and Services, Canada, 1979, pg. 83-84.



#### *a) Proposal for a 'Life-RRIF'*

At the present time, the federal government has introduced the Registered Retirement Income Fund, or RRIF as a payout plan that permits payments to grow from year to year at the rate of return on investment in the fund. To the extent that rates of return reflect price increases, this tends to protect the real value of benefits over time.

A RRIF has a major limitation: payments are made assuming that a person will live to be 90 and are discontinued at that age. Dr. C. Kapsalis of the Economic Council of Canada has suggested that insurance companies participate in making the RRIF a more attractive option for retirement by integrating life expectancies into the RRIF. As a result, benefits will increase annually at the rate of return of investments, as under a RRIF. However, benefits will continue to grow and be paid until the pensioner dies. By tying the RRIF into life expectancies and the concept of a life annuity, the payment of a so-called "Life-RRIF" would be much higher in earlier years than that of a RRIF. This is because there would be no payments made to the estate of the pensioner if he dies before age 90, but remaining funds would accrue to the life insurance pool.

Dr. Kapsalis' proposal is outlined in Appendix C. It appears to provide an opportunity for the insurance industry to demonstrate that it can provide products that are more attractive than current life annuities in an inflationary environment. Although acceptance of any such proposals is required by the Department of Finance to qualify them as options under an RRSP plan, the insurance industry can pilot the use of such innovative annuity products initially in the non-registered annuity market, thereby initiating needed changes in pension product design rather than waiting to react to changes in government policy.

#### *Consumer Complaints*

Consumer complaints have been received by the Committee on the subject of deferred annuity contracts used as RRSP funding vehicles. While few consumers presented an actual, personal example of a complaint based on their purchase experience, the Committee believes that these examples provide some insight into the problems or misunderstandings that the public in general faces in the purchase of the annuity products.

No attempt is made by the Committee to evaluate whether or not a deferred annuity policy is a "good deal" relative to other methods of accumulating funds, or to comment on whether the specific products brought to the Committee's attention were adequate savings vehicles. However, the Committee wishes here to point out to the industry some of the problems brought to its attention by consumers dealing with insurance companies and their representatives. These problems include:

— General dissatisfaction with the purchase of a deferred annuity contract



as a method of accumulating income for the future. Each complainant concluded that if they had been informed adequately at the point of sale, they would not have invested their funds in the specific deferred annuity policy which was bought.

- Misplaced trust in the agent selling the annuity and inference of possible misrepresentation.
- Unwise endorsement of the policy by a professional association and subsequent denial by that association of any responsibility to inform plan participants when an actuarial report showed that the plan was not “a good deal”.
- Complicated and confusing contract terms that prevent the consumer from evaluating what in fact had been purchased.
- Uncooperative response of an insurer in disclosing upon request a statement of deposits, expenses and interest earnings.
- Dissatisfaction with the value of the contract and with the heavy front-end load charges that “locked in” the consumer, as withdrawal of funds would result in substantial financial loss.
- Dissatisfaction with the level of commissions payable.
- Inadequate disclosure of financial penalties and consequences corresponding to contract termination.

Suggestions made to the Committee to alleviate the above problems included:

- Better supervision and training of agents selling annuities.
- Guidelines for associations which recommend RRSP plans to their members.
- More stringent disclosure requirements for RRSP plans which can be confiscatory upon early termination. That is, the consumer should be clearly made to understand the charges and rate of return applied to any plan in which it is possible for him to end up with less money than was contributed.
- Disclosure of commissions payable.

The Committee has also been presented with evidence of poor advertising practices with respect to annuities sold for RRSP purposes. Action to prevent such practices has recently been undertaken and is discussed below.

#### *Guidelines for Advertising and Disclosure of Rates of Return on RRSP plans*

The adequacy of disclosure of rates of return on RRSP funds is of con-

cern not only in the context of the life insurance industry but in the context of all financial institutions selling RRSP products. A recent call by Provincial Superintendents of Insurance toward uniform disclosure of rates of return was made to correct problems that were also being reported to the Committee during its hearings. The Committee was informed of the practice of at least one major insurance company of advertising a relatively high guaranteed payout return over a certain period, while indicating only in much smaller print that a start-up cost was charged, thereby guaranteeing this return on net premiums paid rather than gross premiums, as might be presumed by the purchaser.

The Superintendent of Insurance in Ontario also informed the Committee that the matter of proper and adequate disclosure in the sale of an RRSP and the matter of inadequate explanation with respect to the front-end load, particularly regarding RRSPs, were major areas of concern reflected in complaints to his office about life insurance.

The Superintendent went on to explain that:

“Sometimes, it is indicated to the RRSP buyer that he would get 10 percent a year or more on his money. What may be left out is that he would get 10 percent after all charges and expenses are taken off, that is 10 percent on the net contribution, rather than the gross contribution.

The omission of this subtlety often leads to confusion and misunderstanding.”

The Committee learned that as a result of the efforts of the Ontario Department of Insurance, endorsed by the Provincial Superintendents of Insurance, guidelines were prepared by a joint government-industry committee to protect buyers of registered retirement savings plans in Ontario from misleading or deceptive printed and media advertisements. Involved in preparing the guidelines were representatives of the Trust Companies Association of Canada, the Canadian Life Insurance Association, the Investment Funds Institute of Canada, the Ontario Credit Union League, in consultation with the Canadian Bankers Association as well as the Marketing Branch of the federal department of Consumer and Corporate Affairs.

The guidelines stress that RRSPs are vehicles for the accumulation of retirement income and not just tax saving devices:

“Whenever tax saving is described as an advantage in printed material, it will be indicated that ultimately all benefits received must be added to income.”

The guidelines include further standards for advertising and are set out in full in Appendix D.

The Committee commends the Superintendents, the life insurance in-

dustry and other financial institutions in acting positively to resolve the problems of advertising and disclosure of rates of return on RRSP plans.

While some success has been obtained in this instance, the Committee continues to be concerned about the standards of disclosure regarding other aspects of the marketing of RRSP's. This concern arises because regulation of the financial institutions in the RRSP market falls under a number of statutes including The Insurance Act. As a result, there is no formal mechanism for ensuring that common standards of consumer protection will continue to develop, when needed, in the RRSP market.

#### **D. OVERVIEW OF THE ANNUITY BUSINESS OF LIFE INSURERS**

The joint participation of life insurers in the broad system of financial protection, with other financial institutions, is clearly evident in the annuity business, and more particularly in that part of the annuity business which overlaps with the market for RRSPs. This situation from the perspective of government regulations of life insurers has at least three consequences.

The first consequence is that the participation of life insurers in product areas served by other financial institutions appears to subject the life insurance industry to increased competition. This appears to be particularly the case in the pay-in or funding segment of the annuity business. This factor may have positive implications for regulation, as a greater degree of competition may result in a reduced need for regulation.

The broad-based competitive environment in the sale of annuity and retirement income products is therefore a factor which the Committee must take into account in its consideration of the annuity business, even though the Committee's recommendations focus on that part of the overall market served by life insurance companies.

The second consequence, referred to above, is that the participation of several financial institutions in a market such as the RRSP market can present jurisdictional problems for regulation, when regulation is required. Because regulation of the various financial institutions falls under separate statutes, there is no mechanism to ensure that common marketing standards are applied to all market participants. As a result, concerns arise, such as those voiced by the life insurance industry, that regulation of life insurance companies could impose standards on their annuity products which would make them non-competitive with non-regulated options in other sectors of the RRSP market.

In this matter, the Committee also expresses concern but from the point of view of the consumer, who may become confused by, for example, differing standards of disclosure, when shopping for a similar product among competing financial institutions.

A final consequence of insurer participation in that part of the annuity market which overlaps with the RRSP market, arises out of the influence of personal income tax regulation on the RRSP market. To a large extent, innovation in the products sold by the life insurance industry for registered purposes, and less directly for non-registered purposes, is determined by the income tax rules governing RRSPs. In many ways, these rules are restrictive on the type of products sold as RRSP plans. On the other hand, they present an opportunity for insurance companies to become more involved in the “savings” market, in ways which perhaps deviate from the industry’s traditional base of products related to life contingency.

In sum, it would appear that the annuity market is greatly shaped by income tax restrictions, on the one hand, and by tax-savings-inspired market opportunities, on the other hand. Again, this creates a problem for:

- the life insurance industry in meeting its consumer responsibilities—the industry must determine to what extent it should seek to influence tax legislation or whether it should simply react to public tax policies;
- consumer protection regulation as certain aspects of consumer need can only be met by amendment of tax rules;
- the Committee in setting out recommendations which meet its concerns in the annuity area.

While the Committee’s recommendations are related specifically to the role of the life insurance industry in meeting consumer needs within the framework of existing income tax legislation, this does not preclude the Committee from expecting that the life insurance industry will seek to introduce improved annuity products that may become acceptable as RRSP vehicles in the future.

While acknowledging the competition of other financial institutions in various parts of the annuity business of life insurance companies and the consequences of such market overlap on regulation, the Committee must nevertheless focus its recommendations on the life insurance industry, as outlined in the following section.

## **E. RECOMMENDATIONS WITH RESPECT TO THE ANNUITY BUSINESS OF LIFE INSURANCE COMPANIES**

### **1. Amendments to The Insurance Act**

The Committee has reviewed the annuity business of life insurance companies in this Province and is concerned about the lack of explicit reference in The Insurance Act to this increasingly important component of the overall life insurance market. The Committee’s concern is magnified by the important role that annuities, particularly life annuities, play in the retirement and pension income system in this country. Accordingly,



- 5.1 The Committee recommends that immediate attention be given to amending The Insurance Act in Ontario to include annuity contracts explicitly within the scope of the insurance business governed by the Act. Attention should be given in the Act to defining both a life annuity and an annuity certain in a practical and non-ambiguous manner. Amendments to the Act should further ensure that the provisions of The Insurance Act which apply to life insurance apply uniformly to annuities, except where specifically excluded for reasons of inappropriateness.

## **2. Importance of a System of Disclosure for Annuity Products**

- 5.2 The Committee recommends that the duty of life insurance companies to inform consumers, recommended as a provision in law by the Committee in application to the business of life insurance which provides death benefits, apply equally to the business of annuity contracts.

To carry out the intent of this recommendation, the Committee foresees the need for developing a mandatory system of disclosure for annuity products which brings to the consumer's attention basic annuity policy features and policy costs.

- 5.3 The Committee recommends that the particulars of a mandatory system of disclosure for annuities be worked out by the Superintendent, corresponding to recommendations made by this Committee with respect to disclosure for individual insurance policies as detailed in Chapter 9 of this Report. The Committee emphasizes the particular importance of point-of-sale disclosure with respect to single-premium, immediate life annuities, as the 10-day rescission right provided for most life insurance products is generally not applied to single-premium or immediate annuities, whose payout values vary in accordance with changes in market rates of interest, which are subject to change at any time.
- 5.4 Whether or not a mandatory system of disclosure for annuity products is adopted by the government, the Committee recommends that Part V of the Act be reviewed and amended to take into account the business of annuities. The Committee recommends that specific attention be given, in amending Part V, to provisions governing the contents of an annuity policy.

Amendments should ensure that similar provisions, where applicable are set out in each annuity policy, as required for life insurance policies under section 149(2) of the Act, and as recommended by the Committee in the previous Chapter. Following are the Committee's more specific suggestions for consideration by the Superintendent in revising Part V of The Insurance Act.

5.5 Specific provisions should be made in Part V of The Insurance Act, with reference to deferred annuities, for disclosure as part of the policy contents of:

- the annuity options available upon maturity of a deferred annuity;
- the amount, if any, guaranteed to be paid annually per \$1,000 of premium contributed under the life annuity option of a deferred annuity contract, if a life annuity is included as an option at maturity;
- redemption privileges, if any, and the conditions or qualifications pertaining to redemption, including special conditions pertaining to policies registered as RRSPs;
- the amounts, if any, payable upon redemption, that is, the guaranteed cash surrender value, set out in a table for the period to maturity of the annuity; or the methods of determining redemption values, if not guaranteed;
- the amounts or methods of determining redemption or withdrawal penalties, if any.

5.6 Specific provisions should be made in Part V of The Insurance Act, with reference to the payout period on immediate annuities, for disclosure as part of the policy of:

- the periodic income guaranteed payable under the immediate annuity contract, stated on an annual or more frequent basis;
- statement of differences in the amount of periodic income payable, if paid on a more frequent than annual basis;
- methods of determining the periodic amounts payable under the annuity contract, if not guaranteed or if not level in amount.

In drafting either a mandatory system of disclosure or provisions in The Insurance Act pertaining to annuity contracts, the Committee believes that it is important to recognize in the wording and content of disclosure provisions that the annuity products sold by life insurance companies compete in a larger market for savings plans and RRSP plans with products of other financial institutions. Hence, consumer needs for information on annuity products should be identified in the broader context of the whole private retirement planning system, rather than simply in the context of the business of life insurers.

The Committee also encourages the Superintendent, wherever possible, to cooperate with consumer groups and with other financial institutions that compete with life insurance companies in setting up common standards of disclosure and advertising in the private retirement planning system. However, initiatives toward improved disclosure for the annuity products of life insurance companies should not be held back because of a lack of agreement on disclosure standards for all financial institutions in the retirement savings market.

### **3. Standards for Provision of Rate of Return on Annuity Contracts**

Various methods are currently in use for comparing one annuity product with another. An increasingly common practice is for life insurance companies to state the interest rate to be paid on the sums deposited in a deferred annuity. This rate may be guaranteed under various conditions. This method of quoting on annuity products permits the consumer to compare the rate at which funds are accumulated towards payment of monthly income in the future. It also permits the policyholder to compare the rate of accumulation under a deferred annuity contract with the rate of cash accumulation in other methods of savings.

- 5.7 The Committee recommends that the industry make universal the practice of stating in the policy and in sales proposals the rate of return applied to a deferred annuity contract. The Committee furthermore recommends that, where rates of return are stated in the policy or are advertised, the manner in which the rate is calculated and set out should be subject to consistent standards of disclosure that serve to protect the consumer against misunderstanding and confusion. The Committee recommends that the Superintendent include appropriate standards as regulations under The Insurance Act.

Such standards have recently been developed as guidelines pertaining to the sale and advertising of RRSP plans, as outlined in this chapter. In the matter of rates of return, the Committee believes that similar guidelines should be made applicable to *all* annuity policies and not just those registered as RRSPs.

Of particular concern to the Committee is that the quote of a rate of return clearly identifies whether it applies to a gross premium basis or a net premium basis.

- 5.8 The Committee endorses the method of quoting rates of return on “a gross premiums paid” basis, with a clear statement that the rate of return is based on gross contributions, and with additional full disclosure of the total of all front-end load charges, which will include administration fees and commissions payable. Nevertheless, the method of quoting the rate of return could be left to individual company discretion so long as standards of disclosure are rigorously followed with respect to identifying the basis for the rate of return calculation. This matter should be considered by the Superintendent in developing comparable standards of disclosure for annuity products.

### **4. The Suitability of Products for Retirement Income Purposes**

In investigating the annuity business of life insurance companies, the Committee has become aware of the dramatic growth of the annuity market and the important role that product innovation has played in the life insur-

ance industry's efforts to match suitable products to the needs of consumers for private retirement income plans.

- 5.9 In light of the many annuity products now available from life insurance companies for purposes of providing retirement income, particularly under registered plans, the Committee urges the life insurance industry to re-examine its marketing of permanent life insurance policies as RRSP vehicles, given that the primary purpose of a life insurance policy is to provide death benefits. Stricter guidelines than those currently adopted by the CLIA must be implemented to inform the consumer that loss of insurance coverage would result if RRSP annuity options were exercised and to make it possible for the policyholder to compare the results of registering a life policy with other methods of accumulating funds for RRSP purposes.

It has also become apparent from the Committee's investigations that further innovation and product adaptation is needed in annuity products to meet the current and future needs of retirement income planning.

- 5.10 In regard to annuity products, the Committee strongly urges the life insurance industry to re-examine its product design and methods of product pricing so as to:

- design products that attempt to protect the real value of annuity benefits over time while maintaining products that guarantee benefits, to provide choice to consumers;
- make participating annuities more attractive to consumers;
- provide better opportunities for applicants to purchase substandard life annuities, when such applicants can provide evidence of shorter life expectancy.

These are all areas in which the Committee believes significant insurer efforts are urgently required to demonstrate the ability of a private system to meet retirement income needs now and in the future.





## CHAPTER 6

### Group Insurance

#### A. INTRODUCTION

The two previous Chapters have addressed life insurance and annuity products in the context of sales to individuals. This Chapter turns to group coverage, addressing in turn:

- group life insurance
- creditor's group insurance, and
- group pensions

With each of these areas, the discussion begins with a review of the products provided by life insurers to the group market. Discussions then turn to consideration of matters identified to the Committee as problems in the provision of group coverage.

#### B. GROUP LIFE INSURANCE

##### 1. Introduction

###### *Group Life Insurance Business*

Group life insurance including creditor's group insurance represents some 40 percent of total group premium income collected by life insurance companies in Canada. The majority or 60 percent of group business is in group annuities and associated pension services.

###### *Types of Groups*

The majority of group life insurance coverage, some 87 percent in 1977, is of the employer-employee group type with the remainder made up of coverage provided to unions, trade or professional associations and other qualifying groups. It is apparent that group life insurance has become an integral part of the overall compensation and benefits package provided by employers for groups of as few as 5 employees.

###### *Growth in Group Life Insurance*

At the end of 1978, 58 percent of all life insurance in force was group life insurance, amounting to \$192 billion. This is an increase from the 47 percent share or \$56 billion in 1970 and the 31 percent share or \$15 billion in 1960.

In terms of premium income, group life insurance sales were \$21.9 billion in 1978, compared to \$5.2 billion in 1970 and \$1.6 billion in 1960. There is however some indication that group sales may have reached a plateau. It is reported that sales of group life insurance, after recording a small

gain in 1979 to about \$22 billion, are expected to repeat their performance with “only a modest increase” in 1980. This is attributed to poor business expectations which are said to be reflected in slower increases in group insurance benefits provided by employers.<sup>1</sup>

At the same time, it is reported by the life insurance industry that the market for group life insurance plans is probably saturated. A large proportion of the new business volume reported annually by the life insurance industry is said to involve the replacement at least of some coverage previously in force. With a high replacement rate, increases in group insurance sales are dependent on salary and benefits increases. The outlook for future growth in group insurance sales is therefore tied closely into economic conditions.

*Ownership of Group Life Insurance*

Among the population in general, a survey conducted by the CLIA in 1977 indicated the following distribution of life insurance ownership, compared to a similar survey in 1971.

TABLE 1  
OWNERSHIP OF LIFE INSURANCE

	1971	1977
Group Life Insurance only	13%	14%
Both Group and Personal	41	39
Personal Life Insurance only	28	26
Have No Insurance	17	20
Not Stated	1	1
Total of Sample Population	100%	100%

Source: Centre De Recherches Contemporaines Limitee, “Data Base II: Attitudes of the Canadian Public Towards Life Insurance”, A Research Study Conducted for the CLIA, June 1977.

Just over half of those persons surveyed had group coverage, either on its own or in conjunction with personal insurance. Participation in group insurance coverage remained about the same for the populations sampled in 1971 and in 1977.

Some 13 to 14 percent of persons questioned indicated ownership of group life insurance only. Included in this category are some persons who likely would be uninsurable or would be rated substandard for individual policies.

1. *Globe and Mail*, “Life Insurers expect sales growth of 16% to be repeated next year”, December 19, 1979.

## *Group Term and Group Permanent Insurance*

Group life insurance is for the most part written as one year *term coverage*. If the plan is renewed at the end of the plan year, a new premium rate is calculated.

Group permanent insurance based on *permanent plans* of insurance such as whole life or endowment is also available but is not commonly sold. Level annual premiums are charged based on the employee's age at the effective date of his or her insurance. The life company reserves the right to change the rates applicable to new employees and to any increase in the insurance of present employees. The employee receives a certificate setting forth his or her rights and the cash value and non-foreiture values available in case of termination of employment. The insurance may be continued after termination of employment as an individual policy. In general, group permanent insurance is less suitable for group coverage purposes when the continuity of association with the group can be terminated, as is the case with an employment situation. In such cases the insured may wish to terminate his policy as employer contributions stop, but will be faced with low cash values if coverage has been in force for only a short period of time.

Some group insurance plans give the employee the option of taking insurance on either a term insurance basis or a permanent insurance basis. In these plans the employer pays the entire term insurance cost no matter which form of insurance the employee chooses. Those electing permanent insurance contribute the excess cost of the permanent insurance over the cost of the term insurance.

## **2. The Fundamentals of Group Life Insurance**

During the course of its hearings the Committee had the opportunity to learn about the fundamentals of group life insurance from the CLIA and the London Life Insurance Company and also had the pleasure of meeting with Mr. Reuben A. Hasson, Professor of Law, Osgoode Hall Law School in Toronto, who discussed the proposals he has made for reform of group life insurance law.<sup>1</sup>

The fundamentals of group life insurance can be summarized in the following points adapted in part from Mr. Hasson's paper for the *Manitoba Law Journal*<sup>2</sup>:

- A group life insurance contract is entered into between an insurer and an employer or group administrator who is the policyholder. The contract is entered into for the benefit of the employees or group members who are the insureds under the policy.

1. See R. A. Hasson, "The Reform of Group Life Insurance Law", *Manitoba Law Journal*, Vol. 9, No. 2, 1979, pgs. 119-139.

2. R. A. Hasson, *op. cit.*, pg. 121.



- In the early days of group insurance, the minimum number of employees for a plan to be accepted without medical examination or evidence of insurability was 100. This number has become progressively reduced and is now as low as ten. Even smaller groups, as low as three in number, are sold group coverage, but typically, a medical examination is requested in these cases and in a few other situations.
- If the insurance plan is non-contributory, that is, the employer pays the whole premium, 100% of the eligible employees must be included in the group. If the employees pay part of the premium, under a contributory plan, then insurers insist that at least 75% of the eligible employees come into the plan and that that proportion remain in it.
- Insurance is usually written on a one-year term basis but it is possible to combine this term insurance with group permanent life insurance.
- Group life insurance is said to have distinct advantages for employers, employees and insurance companies. The employer benefits by offering a benefit, at low cost, to his employees. The employee benefits by obtaining insurance at modest cost without the necessity of a physical examination. For the insurer, group insurance is attractive because many of the high costs of policy administration and issue are eliminated.

The Committee's further review of the business of group life insurance indicates that the rigid and standardized group plans of the past have yielded to a greater variety of services being provided to buyers by the life insurance industry. In some cases, it is almost being said that there is "less insurance in group insurance" because of the proliferation of new, tax-effective financing options available to employers with group life insurance plans. From the buyers' perspective the greater flexibility of insurance companies in tailor-making plans to suit their particular needs is surely welcomed.

### **3. Problems in Group Life Insurance**

Group life insurance is not however without its critics. It is argued that since insurance companies are so willing to accommodate the buyers of group insurance, be they employers or other group administrators, they may do so without due concern for the situation of employees or other members insured under the plans.

In this regard, Mr. Hasson has made the following comment with specific reference to employer-employee groups:

"Before discussing the problems of group life insurance law in detail, it is necessary to stress that many, if not most, of the problems arise from the fact that the policyholder (the employer) is not the same person as the insured (employee). For one thing, when the policyholder buys a policy for someone else, he (the policyholder) is less likely to scrutinize the policy to see if there are unfair terms than if he were buy-

ing the policy for himself. In a group life situation, there is very strong pressure on the employer to consider only the price of the policy and to ignore the question of whether the policy provisions are fair or not. Further, it is true that very few insureds are able to get insurers to delete obnoxious provisions from their policies but sometimes they have been able to do so. In the group life situation, it is impossible for the insured employees to get the insurer to remove an obnoxious provision since the employees get no notice of the policy provisions at all.

An even more serious difficulty arises from the fact that the policyholder is not the insured. The fact that the policyholder is not the insured means that he (the policyholder) can by wilful or careless acts extinguish the insured's rights without the insured being aware that this has happened."<sup>1</sup>

Later sections of this Chapter address some of the "problems" in group life insurance referred to in the above quote as well as others brought to the Committee's attention during its public hearings. In regard to some of these matters, the Committee has received a submission from the CLIA indicating its members' views on proposed reforms to current practices. Reference will be made to this submission where appropriate.

Before engaging in a review of the "problem" areas noted before the Committee, a review of the regulation of group insurance in this Province is appropriate.

#### **4. Regulation**

The "Uniform Life Insurance Act" which is Part V of The Insurance Act of Ontario deals in detail with policy conditions applicable to insurance policies on individual lives. The Committee finds that references in the Act to group insurance are on the other hand limited to the following:

1. Definition of group insurance and group life insured.
2. The particulars to be set forth in a contract of group insurance.
3. The particulars to be set forth in a certificate of group insurance or other such document for delivery to each group life insured, these being:
  151. "(1) The name of the insurer and an identification of the contract.
  - (2) The amount, or the method of determining the amount, of insurance on the group life insured and on any person whose life is insured under the contract as a person dependent upon, or related to, him.
  - (3) The circumstances in which the insurance terminates and the

1. R. A. Hasson, *op. cit.*, pg. 122.

rights, if any, upon such termination, of the group life insured or of any person whose life is insured under the contract as a person dependent upon, or related to, him.”

In considering the limited reference to group insurance in the Act, the Committee learned that in the early 1900's when group life insurance was first introduced into Canada, it was felt that it would not be legal under the Dominion Insurance Act and the Ontario Insurance Act then in force. It was assumed that acceptance of a risk without medical examination would discriminate against regularly examined policyholders and it was not until 1919 that the federal Department of Insurance changed its views on this matter.

Until the early 1970's, rules of the Provincial Superintendents of Insurance recommended that limits be placed on the amount of insurance coverage available under a group insurance plan. It was not until recent years that restrictions on the amounts of group life insurance that could be offered were eliminated on the grounds that it was in the public interest to permit the development of group plans. In the meantime, dramatic growth had already occurred in the volume of group life business, indicating its acceptance as a convenient and cost-effective approach to life insurance protection.

The Committee finds that the development of rules governing the business of group life insurance has proceeded outside the strictures of The Insurance Act. The Association of Provincial Superintendents of Insurance has developed guidelines governing group life insurance. These guidelines have no force in law but are generally adhered to by life insurers across Canada. The advantage of such “regulation” is said to be that it allows timely changes to be effected in the supervisory activities of the Superintendents. However, the Ontario Superintendent in his submission to the Committee on the topic of life insurance has indicated that only “after years of efforts”, were the rules pertaining to group insurance amended to eliminate the restriction on the amount of coverage.

At the present time the group guidelines of the Superintendents address the following topics:

- the definition of an eligible group;
- prohibition of schedules that discriminate between members or members of a class;
- the conversion privileges to be made available to an insured upon termination of the group contract;
- prohibitions against compensation for solicitation of a group contract by the policyholder or group members;
- assurance of continuation of coverage under certain conditions;
- definition of a “new contract”.

With this background on regulation in mind, the discussion now turns to

“problem” areas identified in group life insurance under the following headings:

- group selection
- contract termination
- rights to convert coverage
- disability provisions
- premium payments and refunds.

## 5. Group Selection

Theoretically, the group concept provides insurance coverage to an individual without evidence of insurability. Exceptions include very small groups where the group concept cannot be applied. Although direct evidence of individual insurability is for the most part not required for the purpose of establishing eligibility for group coverage, indirect evidence of insurability is obtained through group selection.

Group selection is aimed at obtaining a group of persons or, more importantly, an aggregation of such groups that will yield a certain predictable rate of mortality or morbidity. If there is a sufficient number of risks in a group and if they are reasonably *homogeneous* in nature, then such predictability should be attained. To ensure homogeneity, an insurer must determine that certain essential features are either inherent in the group or can be applied in a way to avoid adverse selection by entire groups or a large proportion of individuals within a given group.

One such feature in the early years of group insurance was the requirement that there be no large discrepancies between lowest and highest insured amounts. That is, employees were not permitted to determine for themselves the amount or type of coverage for which they were to be insured, such that all employees received relatively equivalent and generally low benefits. Another feature was that a group was seldom issued coverage unless there were at least 50 to 100 employees in order to spread the risk of any less homogeneous lives. Thirdly to ensure satisfactory enrolment in the plan and hence spreading of the risk, it was required that protection be low-cost, by having the employer contribute to the plan and by achieving economies through large volume operation and payroll deduction for employee premiums.

With the growth in size of the group insurance business, some of the requirements for a group plan were relaxed. Relaxation of “group selection” criteria was made possible because the greater scale of any one insurer’s group business provided a balance against adverse experience in any one plan. As one example of relaxed requirements from the insurer’s viewpoint, contracts changed to reflect an amount of coverage related closely to earnings. This tended to widen the spread between the lowest and highest amounts of insurance at risk within individual groups as well as in the ag-



gregate. In short, with growth in the size of the group insurance business, homogeneity of the risk was becoming impaired.

### *The Actively-at-work Principle*

The extension of group coverage to smaller groups focused attention on a condition of eligibility in a group known as the “*actively-at-work principle*”. This principle stipulates that an employee must be actively at work on a full-time basis and full pay basis to be included under a new plan of group life insurance coverage. It can thus be assumed that the employee is in a reasonable state of health such that all such employees as a group will exhibit a level of mortality or morbidity lower than that of the population as a whole. This requirement is also said to prevent employers, particularly smaller employers, from obtaining “death-bed” coverage for one or more employees.

Under the strict items of this principle, if for any reason the employee is away at the time new coverage or additional amounts of coverage become effective, his insurance would not become effective until he resumes active full-time employment. By force of the rules of the Association of Provincial Superintendents governing group insurance, the actively-at-work clause does not apply on renewal or transfer of previous coverage to a new contract, even if the person is absent from employment on the day of takeover. It does apply however to any improvement of benefits; that is, the away-from-work employee is entitled to be covered only for the old level of benefits.

It is said by the industry that, in practice, the actively-at-work rule is administered more liberally than it is stated contractually, the requirement being that the employee *be able* to be actively at work. For example, in cases such as strikes or lay-offs, the application of the actively-at-work clause could be waived to take account of these situations. The clause may also be waived if the nature of an illness, or reason for being away is stated. In some cases rates may be adjusted to include certain persons who are ill. In other cases, insurers may employ relatively stringent rules, requesting for example a statement of health for senior officers absent from work because of illness at any time in some period such as “the past 12 months”.

Relaxation of certain of the factors associated with group selection has served to expand the market for group coverage, particularly to smaller groups. It has been argued before the Committee that further relaxation be undertaken by removing the actively-at-work requirement from all group life insurance contracts. In regard to the actively-at-work requirement, it is argued that this kind of protection against adverse selection is unnecessary and unfair to bona fide employees who are away from work. It is also argued that the reason for absence should be irrelevant to eligibility for insurance so long as it does not effect a termination of employment.

It is argued by the life insurance industry that the actively-at-work pro-

vision is required to guard against higher than expected costs, arising from inclusion of possibly disabled persons in the group. It is readily apparent that to provide life insurance and waiver of premium coverage without exception and then find that some employees are already disabled would add unexpected cost to the group contract. As for the disabled employee, it is said that any employee who was disabled would be force of the guidelines of the Association of Provincial Superintendents, be covered for life insurance and disability benefits under any previous group contract held by his employer and hence should not suffer from application of the actively-at-work clause. Nevertheless it seems to the Committee that the broad application of the activity-at-work clause could exclude some generally healthy employees from group coverage or from improvements in group coverage should they be unfortunate enough to become disabled or die before resuming work and take a medical examination to qualify under a new or replacing contract of group coverage.

### *The Probationary Work Period*

A similar provision meant to promote group homogeneity is the requirement present in nearly all group policies that the employee serve a probationary period of employment before coverage becomes effective. The *probationary work period* typically runs from 30 to 90 days. While this requirement provides the insurance company some protection against “anti-selection”, the primary purpose of the probationary period is to allow the employer to avoid providing benefits and incurring the associated benefit and administrative record-keeping costs in respect of those employees who remain with the employer for a very short period. The probationary period for insurance coverage often coincides with a probationary employment period for a new employee prior to his becoming a permanent employee.

In regard to the probationary work period requirement, it is argued that a short period is ineffective in separating out good risks from uninsurable risks whereas longer periods are unfair to the employee and his family who are without coverage. The probationary work requirement is also considered to be unfair to an employee who is temporarily denied coverage as a result of having changed jobs. However, the Committee notes that group life insurance does not terminate until 31 days after the employee has terminated employment and that the conversion provision enables the employee to obtain an individual contract of, for example, one year term insurance, to bridge any gap in group insurance coverage.

### *Removal of the Actively-At-Work and Probationary Work Period Requirement*

It has been argued before the Committee that the actively-at-work

clause and the probationary work period are unnecessary conditions for group insurance, on the following bases:

- Insurers are able to cancel a group policy when they suspect a collusive hiring by an employer, for example to obtain death-bed coverage.
- Insurers can ask for evidence of insurability in situations where they fear employers are not being selective enough in their hiring policies.
- Insurers encourage employers in selective hiring by a system of experience rating which gives dividends to employers with favourable claims experience.
- Insurers can refuse to renew coverage at the end of the typical one year term for group contracts.

In light of these protections available to the insurer it is argued that the actively-at-work and probationary work requirements be abolished. These requirements are said to be just as likely to deny coverage to employees who are insurable as good risks as they are to exclude bad risks. As such, these requirements are said to discriminate against certain good risks.

In his submission before the Committee Mr. Hasson has recommended:

- “It is suggested that the actively-at-work requirement should be removed. A model statute should state that the only condition the employee needs to satisfy is that there is bona fide employment relationship. It should, further, be provided that if an employee is unable to work because of disability, or because of leave of absence, temporary lay-off, lock-out, or a strike, that the employment relationship should not be considered terminated, unless the employer chooses expressly to do so.”<sup>1</sup>
- “In the light of all (the) protections available to the insurers, it is suggested that the probationary work requirement should be abolished.”<sup>2</sup>

The Committee notes in considering these recommendations that the intent of the second provision differs somewhat from the first. The first provision is said to be primarily a means of ensuring that the group as a whole exhibits a level of mortality or morbidity that bears a reasonable relationship to that expected and charged for. In this case, removal of the actively-at-work clause would be based on the view that this protection in its current broad sense is not necessarily required by insurers in order to make group insurance work. The second, as stated above, is said to prevent administrative problems in respect of employees who remain with an employer for a very short period. The position could therefore be taken that the application of a

1. R. A. Hasson *op. cit.*, pg. 129.

2. *Ibid.*, pg. 130.



probationary work period clause should be a matter for employer discretion rather than insurer discretion.

## **6. Contract Termination**

Mr. Hasson, in his review of group life insurance law, has examined group contract termination practices and has identified a vulnerability on the part of the employee as a “beneficiary” under a group life policy. In summary Mr. Hasson’s concerns include:

1. Insurers may terminate or avoid a group life policy because of employer actions, without the individual employee becoming aware of the fact of termination or able to prevent termination.
2. An employer may cancel a group insurance policy either as a cost-saving measure or as a punitive measure against some perceived employee misconduct. An employee may have a legal remedy against his employer in this situation but his rights, and more so the rights of dependants of an employee who died after the policy had been cancelled, are not clearly defined.

Mr. Hasson identified a number of circumstances leading to policy termination or successful insurer avoidance of liability under the contract, citing:

- Non-payment of premiums by the employer when due or within a 30-day grace period as cause for policy termination;
- Insurer refusal to renew a contract because an employer suffers business losses or because past experience under the contract has been unfavourable to the insurer;
- Insurer resistance to liability because of some administrative error on the employer’s part.

The Committee is informed by industry representations that policy termination by the insurer is infrequent and generally related to:

- non-payment of premiums;
- failure to maintain 75% participation under contributory plans; and
- failure to maintain the minimum number of group lives required by the contract.

Even if contract termination is infrequent, protection against cancellation of the group policy by the employer or by the insurer is, in Mr. Hasson’s view, poorly afforded to employees in Canada. Mr. Hasson cites several legal decisions, both in the United States and in Canada, which apply to employee claims under terminated policies but concludes that these decisions do not resolve the problems experienced by employees and their dependants, who may not be aware of a termination of coverage being in effect.



To alleviate these problems, it has been argued that an employee or his dependants should have a right of recovery against the employer. Mr. Hasson points out that this approach may not be satisfactory as an employee may not be able to prove that he has a contract with his employer or, even if he can prove a breach, he may not be able to prove loss.

Mr. Hasson proposes that legislative measures be undertaken to strengthen employee rights and provide for continuity of coverage by defining *insurer liability* in a number of areas. A brief review of Mr. Hasson's proposals and CLIA response to these proposals is presented here. The Committee comments will follow later in this Chapter.

### *Proposal 1.*

The employer's failure to pay a premium under a group life insurance policy should not constitute a valid defence to an employee's claim. An insurer should only be able to terminate a group policy because of overdue premiums if the employer is more than twelve months in arrears with the payment of his (the employer's) premiums. In such a situation, the insurer and the employer should be required to advise employees that coverage is terminating, so that the employees can exercise their right to convert their policies.

### *CLIA Response*

The twelve month grace period during which coverage would remain in force without any premiums being paid to the insurer would impose an onerous financial burden on the insurance company and on other group policyholders. The unscrupulous employer would pay the overdue premiums only if claims were incurred during the grace period. If no claims were incurred, the employer, with the complete support of the employees, would let the coverage lapse at the end of the twelve month grace period without paying the overdue premiums, having obtained free insurance coverage for one year.

### *Proposal 2.*

The insurer should have to prove that the employer has been making fraudulent misrepresentations, or has otherwise been misusing the group insurance device, in order to terminate the contract.

### *CLIA Response*

The requirement that the insurance company be able to prove that the employer has been guilty of some form of misconduct in order to terminate the contract seems unnecessarily restrictive. A reasonable period of advance notice of termination should give the employer the opportunity to find replacement coverage.

### *Proposal 3.*

The employer should not be able to cancel a group insurance policy. Similarly an employer should be under an obligation to renew and maintain policies, unless a majority of employees vote to terminate their policies.

### *CLIA Response*

The CLIA had no specific response to this proposal. It seems to the Committee that the insurance industry would certainly benefit by this provision, but that this is a matter more applicable to employment law than to insurance law.

### *Proposal 4.*

Failure on the part of the insurer and the employer to notify employees of the termination of coverage, should render both liable to the employee's dependants for the face amount of the policy.

### *CLIA Response*

If this suggestion were put into law it would have a dramatic effect on group insurance. In effect, insurers and employers would have to institute sign-off procedures with each employee on every group termination. Self-administered groups would create greater problems because insurers do not have names, and in only rare cases do insurers ever have employee addresses.

### *Proposal 5.*

The insurer should be held liable for an employer's errors in administering a group insurance policy. This proposal is based on the employer acting as the agent of the insurer in determining eligibility under the policy. Insurers can protect themselves against employer errors by entering into indemnity agreements with employers whereby employers are made to indemnify insurers for errors made by the employer in administering the policy.

### *CLIA Response*

This suggestion is based on the assumption that the employer is acting as the agent of the insurer in performing any administrative functions with respect to the group policy. The CLIA does not agree with this blanket assumption. It suggests the converse, that the law allow insurance companies to outline specifically the purposes for which an employer is not acting as an agent of the insurer.

The CLIA states further that it should remain acceptable for the insurance contract to provide that clerical errors shall not invalidate insurance

otherwise validly in force and shall not continue insurance otherwise validly terminated, with the premiums being equitably adjusted in all cases.

## 7. Rights to Convert Coverage

An employer-employee group plan of insurance is meant to provide coverage during one's working life only. As group life insurance business has developed, a conversion privilege provision has been inserted into group policies as an addition to the basic life insurance coverage in the plan. This privilege gives employees the right, without evidence of insurability, to convert their group life insurance to an individual policy upon termination of employment, and with some limitation, upon termination of the master contract. This privilege is particularly valuable to those employees whose impaired health is the reason for termination of their employment; to those leaving the workforce or becoming unemployed; and to those joining a new employer with less generous benefits.

In his review of life insurance before the Committee, the Superintendent of Insurance described the development of the rules or guidelines that now pertain to group life insurance and stressed the importance of conversion privileges in this statement:

“We had to bear in mind that without satisfactory conversion privileges in place, a person relying extensively on group insurance would find themselves trapped should they leave the group in poor health.”

The Superintendent pointed out that, in the early 1970's, the conversion privilege most typically extended was the right to convert to a permanent life insurance policy. It was available before age 65 only on termination of the member's employment or on termination of membership in the group but not on termination of the contract. He indicated that the Office of the Superintendent of Ontario actively promoted improved conversion privileges to be built into all group policies. As a result, the group rules or guidelines issued by the Superintendents of the Provinces of Canada now state that:

- A member, before age 65, has the right to convert *without evidence of insurability* on termination of his employment or other termination from membership in the group, the *full* amount of his insurance. That is, he is able to purchase insurance up to the amount for which he was covered under the group plan, at standard rates.
- Further, he has the choice of one of the following types of insurance:
  - (a) one year term insurance with premiums payable quarterly;
  - (b) term insurance to age 65;
  - (c) any other regular plan of the insurer.
- In the event of termination of a group insurance contract that is not replaced or is replaced by insurance of a lesser amount, the rights of a



member to convert *may be limited* to \$5,000 or 25 percent of the amount of insurance on the life of the member in the group plan, whichever is the greater.

These rights can be exercised within thirty-one days after the termination of insurance coverage as a result of termination of the member's employment or membership in the group, or within thirty-one days after the date of termination of the contract.

Three perceived inadequacies of the current conversion rules have been brought to the Committee's attention. First, the group rules and hence the rules regarding the right to conversion privileges are not binding in law on insurers. They are, instead, guidelines issued by the Association of Provincial Superintendents with the expectation that they will be adhered to voluntarily by insurers. In fact, in practice, conversion rights are provided in virtually all contracts. The CLIA conducted a survey of member company practices in 1975 and reported the following results at the 1975 Annual Conference of the Association of Provincial Superintendents of Insurance:

"Nine contracts covering 16,661 lives have no conversion right. Of these, six contracts covering 2,465 lives, provide dependent life insurance which is not convertible or provide a temporary life supplement to death benefit under a pension plan that is not convertible. The remaining three contracts covering 14,196 lives are employer-employee plans where the employer has specifically requested that there be no conversion right and has rejected suggestions from the insurer that this right now be provided."

Second, the limits applicable when a group contract is being terminated and is not being replaced at the date of termination have been perceived to be too low. It has been suggested that conversion should be allowed, even in the situation of a terminated contract, to the full amount of prior group coverage or to some higher percentage of group coverage, say, to 75 percent of the amount of group coverage in effect. The CLIA has stated that the purpose of these limits in this situation is to control the costs of anti-selection inherent in converting group insurance without evidence of insurability. The CLIA states that there is potential for abuse of the conversion right by employers who could continuously terminate group life insurance contracts to permit uninsurable employees, perhaps the employer himself, to accumulate large amounts of non-evidence individual insurance coverage.

The third matter of concern addressed to the Committee is that of the options available at the time of conversion. It is argued that the conversion options as presently stated do not necessarily provide the consumer with the option of buying the type of insurance coverage he requires. That is, the third option of buying any other regular plan of the insurer restricts the choice of coverage to plans sold by that insurer on a regular basis. These may not include certain policies, for example, yearly renewable term or five



year renewable term, which the group insured may prefer to purchase. It has therefore been suggested that all companies make available for purposes of a conversion option, a full range of personal plans, that include participating and non-participating policies and various types of term plans that are renewable and convertible. It is argued that the two term options in present group rules are not satisfactory in assuring a wide choice to the group life insured upon conversion. It is said that such a choice is necessary if group life insurance is to be considered an integral part of an individual's life insurance program and not simply an add-on.

## **8. Disability Provisions**

In addition to the basic life insurance provided and the conversion privilege, the group policy will usually contain a disability provision. Two main types of disability provisions are currently offered in group life insurance contracts: a waiver of premium provision and a disability instalment provision. As in individual policies, the waiver of premium provision may vary in terms among companies but basically it provides that, in the case an employee becomes totally disabled, future premiums under the group contract will be waived by the insurance company.

The disability instalment provision, although it is not offered in all group contracts, is available for an extra premium. It provides that in case an employee is totally and permanently disabled, the amount of insurance benefits under the policy will be paid in regular instalments over a period of years, usually 5. This provides the disabled person with the benefit of income payments out of his group life policy. The instalment payments however reduce the amount of insurance in force and at the end of the payment period, the life insurance contract is terminated. Termination of coverage through payment of the sum insured may provide needed disability benefits to the disabled employee but it results in loss of life insurance coverage at a time when ordinary life insurance may be difficult to obtain.

The terms of the disability instalment provision in effect alter the life insurance contract to a contract of disability benefits. In some cases, the disabled employee may not regard this disposition of his life insurance coverage to be most appropriate to his circumstances but no other options are made available to him with this provision in force.

In regard to disabled persons, there is also concern over the continuity of coverage between old and new contracts. Under the actively-at-work provision on new and replacing contracts, the disabled employee will not qualify for new or expanded benefits. He must rely on whatever coverage was made available under any previous group contract held by his employer. Under a disability instalment provision this could result in loss of insurance coverage after a number of years, or coverage could be lost if a waiver of premium rider were missing on the old contract. This situation may not be

adequately provided for in all group contracts and it has been suggested to the Committee that perhaps it should be covered by statute by requiring that a waiver of premium rider be provided in all group contracts and by providing disabled employees covered by disability instalment provisions with a choice of either continuing coverage or disability payments.

## **9. Premium Payments and Refunds**

### *Determination of Applicable Premium Rates*

As noted earlier in this chapter, group selection techniques ensure that the group written by a life insurance company produces average or predictable mortality and morbidity rates. In order to determine the applicable premium rates, mortality rates are broken down and analyzed according to the following factors:

- Age. As life expectancy decreases with age, basic premium rates are developed by the age structure of the group lives.
- Sex. The more favourable mortality experience of females is reflected in discounts for female lives in the group.
- Industry. Statistics on intercompany mortality experience by broad industry classifications have been gathered and indicate wide differences. It has become common for insurers to use these results, often modified by the company's own experience, in establishing expected mortality levels for various industry groupings.
- Geographic Area. Some classification of risks by geographic area is made based on data showing mortality differences in provincial or regional mortality results. Often companies modify available data by their own experience.
- Claims Experience. A final modification is made to reflect the influence of any previous experience data available on the group. This modification is applied primarily to medium and large groups, with some adjustment made to small groups. A credibility formula is used to determine to what extent previous experience should be used to modify rates. Some insurers will not accept a group plan without seeing all previous claims experience.

The insurer modifies basic rates by the various factors described above to produce rates specific to each group. At renewal, rates are re-evaluated to take into account current age, sex and claims experience factors.

### *Employer Funding*

Under an employer-employee group plan, the employer pays the premium to the insurance company. Employees in many plans make contribu-

tions but the whole amount billed is remitted by the employer. The amount of employee contributions must be stated in the master contract.

Insurance companies favour group contracts where the employer pays much or all of the premium, with employee contributions kept at a low, flat rate. Employer funding has several advantages to the insurer:

- It makes group coverage more attractive to the employee and ensures the satisfactory enrolment required by insurers to make group coverage work at a cost lower than individual coverage;
- It protects the insurer from getting just the unhealthy lives in the group as would be the case if healthier lives decided not to buy life insurance or decided to use their contributions to purchase coverage outside the group;
- It gives the employer a financial stake in the plan, ensuring his active interest in the operation of the plan and in its proper administration;
- It ensures that fluctuations in the cost of the plan from year to year are absorbed by the employer without affecting employee participation.

### *Refunds*

As stated earlier, the amount of total contributions paid to the insurer is modified over time to reflect the mortality experience of the group as well as other cost factors. Most group contracts provide for refund of premiums to the policyholder, that is, the employer, in the event that premium rates were set higher than subsequent mortality experience in the group proved was necessary. Participating contracts pay dividends; non-participating contracts pay experience rating refunds. The employer in receiving a refund or dividend often applies it in the following ways:

- Accumulated dividends may be used to buy extra benefits;
- Dividends may be used to reduce the employer's own cost of contributions;
- Dividends may be used to stabilize the cost of claims;
- Employers sometimes declare a premium holiday for employees contributing to group coverage.

As the insurance company has entered into a master contract with the employer and all premiums are billed to the employer, it has no direct responsibility to inform employees under the group contract that a refund has been paid or to see that some part of the refund might accrue to the employees. Rather, the distribution of group coverage refunds could come up as a matter of negotiation between employer and employees but is most typically left to the policy of the employer.

## 10. General Observations on the Business of Group Life Insurance

### *Protection of the Individual*

The value of life insurance to the individual has long been recognized and has been the basis for regulation of the life insurance industry. Accordingly, if government regulation is intended to protect individuals in their coverage under life insurance, it seems to the Committee that this protection should apply to all individuals regardless of whether they are single policyholders, employees or otherwise members of a group plan. That is, good insurance should be provided equally to all insureds whether they are buying personal insurance or are covered under a group contract.

The Committee believes that persons insured under group contracts have similar protection needs to persons insured under individual policies. All persons concerned about life insurance coverage are concerned about:

- their eligibility for coverage and how it is assessed,
- continuity of coverage,
- security that promised benefits will be paid,
- adequate information with respect to benefits and rights and any changes therein,
- some consistency in provisions to maintain basic coverage even if insurers or products change,
- the best product for the best price.

It would seem inappropriate, in the Committee's opinion, to deny or restrict an insured's rights in a group policy if he would otherwise qualify for these rights under any normal plan of insurance bought individually.

### *The Insured as Third-Party Beneficiary and the Need for Government Regulation*

Under a group life insurance contract, the insured is in a sense a third-party beneficiary. He benefits from protection made available to him through an intermediary process of group coverage. It has been argued before the Committee that this intermediary process may, however, provide less than adequate protection to the individual plan member for the following reasons:

- The intermediary buyer of life insurance coverage cannot be expected to act always in the plan member's best interest.
- The buyer can either wilfully or carelessly cancel the insured's rights without the insured being aware that this has happened.
- The insured is likely to rely on either the buyer or the insurer to provide a fair contract as he is less likely to dispute the terms of something he has not bought himself and as he may not even be given the opportunity to scrutinize the terms of his coverage.



It has in fact been argued that, because of the lack of a direct transaction or contract with the seller of life insurance or annuity coverage, there is a greater need for government regulation to define the rights of insureds under a group plan and perhaps even to prescribe the basic provisions essential to adequate protection.

The government has in fact stepped in to define certain employee rights with respect to group benefit plans, through provisions in The Employment Standards Act. The Committee believes that the rights of insured or group members under a group life insurance contract should also be protected, where necessary, under the provisions of The Insurance Act. The Committee will comment further on this matter in the next section.

It is of concern to the Committee in considering any further regulation of group insurance on behalf of the third-party beneficiary, that the group business of life insurance companies may be more vulnerable than the individual business to changes in government regulation which are not adopted in other jurisdictions. That is, group sponsors may place group business with insurers outside of a Province if in-Province rules are found to be restrictive or to create higher costs. There are no requirements under any law, including The Employment Standards Act, that group plans be insured with companies licensed in this Province and hence subject to regulations in this Province. Nor are there any rules prohibiting self-insurance—an alternative course which employers or other groups may follow if they see cost or administrative disadvantages to regulations placed on insured plans. As group sponsors are free to place business anywhere, larger groups in particular, may seek to avoid doing business with insurers operating under laws that add cost to their products.

### *Responsibility of Insurance Companies*

Despite a primary employer responsibility in many areas of group benefit plans and despite government regulation in this field, the Committee emphasizes that there should also be some shared responsibility by insurance companies in ensuring that the needs of group members are met in those instances where insurers provide group products and services. This responsibility should in a broad sense include:

- In regard to adequate benefit amounts, insurance companies should demonstrate efficiency in operations, wise investment policies and flexibility in pricing and plan design *to return as much in the way of benefits to the employee as is possible* for the level of contributions made into an “insured” group plan.
- In regard to availability of or eligibility for coverage, insurance companies should not on their part unduly restrict participation in group plans by applying underwriting criteria that may exclude healthy employees

from group coverage. Such is sometimes the case with strict application of the actively-at-work principle in group life insurance.

- In regard to continuity of coverage, insurance companies have a responsibility to demonstrate that gaps in coverage can be reduced or bridged by group plans managed by the private sector.

Major issues related to continuity of coverage, such as conversion rights in group life plans and the rights of insurers or employers to terminate contracts should be addressed by the life insurance industry, with the aim of improving methods of bridging gaps in coverage. Improvements should focus on methods of bridging that provide the greatest flexibility to consumers in obtaining the coverage best suited to their individual circumstances.

- In regard to information about benefits, rights under the insurance plan and factors that affect or change coverage, insurance companies should be prepared to provide group insureds, and not only the group policyholder or employer, with details of coverage, in a timely and understandable fashion. It would not seem to be appropriate to rely on the employer to interpret the life insurance or pension contract for his employees when the expertise in outlining coverage lies with the insurer.

It is particularly important that life insurers respond to the needs of group insureds on behalf of the smaller groups which rely on insurers for advice and service beyond the mere acceptance of risk under a group contract.

## **11. Recommendations with Respect to Group Life Insurance**

With the foregoing in mind, the Committee turns to its recommendations with respect to the regulation of group life insurance.

### *Amendments to the Insurance Act*

The Uniform Act deals in detail with policy conditions applicable to insurance policies on individual lives. It addresses group life insurance only in certain limited areas. Guidelines prepared by the Association of Provincial Superintendents indicate how the industry is expected to act regarding group life insurance but these guidelines have no force in law.

- 6.1 The Committee recommends that the field of group life insurance should be addressed specifically and completely in The Insurance Act. The business of group life insurance is a mature business with clearly established standards of operation. These standards, where they are in the best interests of the public, should be recognized in The Insurance Act as applicable to all companies licensed in this Province.
- 6.2 The Committee recommends further that the current rules of the Association of Provincial Superintendents of Insurance which govern group

life insurance be formally adopted in life insurance regulation. The Committee recommends that the Superintendent undertake to amend or expand the group rules in accordance with the Committee's further recommendations in this Chapter before they are brought under a statutory framework.

A number of the Committee's recommendations for amendments or additions to the group rules are set out in the following pages.

- 6.3 The Committee emphasizes that the primary purpose of regulations pertaining to group life insurance coverage should be to provide group insured lives with the assurance of continuity of coverage, particularly with respect to situations of termination of group coverage and with respect to persons who are disabled while covered by a contract of group insurance, even if that contract is terminated at some later date. In regard to the latter point, the Committee recommends that The Insurance Act be amended to make it mandatory that all group contracts provide waiver of premium coverage in the event of disability.

#### *The Probationary Work Period*

It has been proposed to the Committee that this condition of eligibility for group coverage be removed. The Committee concludes that the probationary work period is a matter of employer-employee relations and is often a device used to eliminate temporary employees from fringe benefits such as insurance coverage. It is a provision that can be waived if the employer so desires.

- 6.4 The Committee concludes in regard to the probationary work period provision in group contracts that if employers are to be compelled to provide insurance benefits to new employees from the moment they are hired, then such regulations should be considered as part of The Employment Standards Act. The Committee does not recommend such regulation in The Insurance Act.

#### *The Actively-At-Work Requirement*

- 6.5 The Committee finds that the actively-at-work condition of eligibility for group coverage is just as likely to deny coverage to employees who are insurable as good risks as to exclude bad risks from group coverage. The Committee concludes that the actively-at-work requirement should be eliminated as a general condition of eligibility for group coverage. The only condition of eligibility that an employee would then need to satisfy for group coverage would be to show that he or she is a bona fide employee within the group sponsored for coverage.

The Committee, however, recognizes that elimination of this clause could have disadvantages in certain situations. The actively-at-work require-



ment is a uniform and simple test of admissibility to group coverage. Elimination of this test might put insurers back into the position of requiring medical information on certain employees who are absent from work, so that group rates can be adjusted accordingly. Alternatively, contracts might be written to exclude employees with pre-existing serious impairments.

On the whole, however, the Committee finds that the actively-at-work requirement is too broad-sweeping and for this reason is often waived in practice. The Committee believes that insurance companies have sufficient means of protecting themselves against adverse selection without the need to rely any further on the convenient, but arbitrary rule that employees be actively at work.

### *The Group Member's Rights to Convert His Policy*

- 6.6 The Committee recommends unequivocally that the rights of employees or other group insureds to convert their group life insurance to an individual policy upon termination of employment or termination of the group insurance contract should be formally set out in The Insurance Act.

This action is in line with the Committee's general recommendation pertaining to formalization in law of the rules which currently govern group life insurance.

- 6.7 The Committee recommends that the conversion privileges extended to group members state clearly that the full range of plans sold by the group carrier should be made available to the group insured.
- 6.8 In the event of termination of a group insurance contract that is replaced by insurance of a lesser amount, the statutory conversion privileges should provide the employee or group member with the right to purchase an individual plan of coverage at standard rates for the full amount of face value difference between the old policy and the new policy.
- 6.9 In the event of termination of a group insurance master contract that is not replaced, the current provisions of the rules governing group life insurance should be made mandatory.

### *Notification of Termination of Contract*

The Committee is of the opinion that the period of 31 days within which conversion privileges are currently permitted is often too short a time for a group member to seek new coverage or exercise conversion privileges, if he is given no prior notification of termination of his membership in the group or of termination of the group contract.

- 6.10 The Committee recommends that The Insurance Act reflect the re-



quirement that notice be given by the insurer to employees and to other group insureds as well as to the group policyholder at least 30 days before contract termination, thereby allowing group members a total of some 60 days in which to consider and act upon the necessity of an individual plan of insurance. This recommendation intends that the insurer remain liable for coverage until 61 days after notification of the intent to terminate coverage is sent to group members.

Notice of group contract termination or non-renewal is now commonly provided to the group policyholder but not necessarily to group members. The notice provided prior to termination of a contract should set out the conversion rights available to the insured and generally alert him that his group coverage will be eliminated or reduced. The notice should also state whether contract non-renewal was an insurer decision or a group administrator decision. Waiver of this requirement should only be permitted if the existing insurer is notified by the employer or group administrator that replacement insurance coverage in the same or a greater amount will be provided upon termination of the existing contract.

#### *Other Considerations in Regard to Group Contract Terminations*

The Committee has considered other measures in addition to notification as a means of protecting group members in the event of group contract termination. Of particular concern is the situation where group coverage is terminated because of the failure of the employer to pay premiums. The Committee has concluded that it cannot, under insurance law, protect employees from such employer action, except with the requirement that advance notice of non-renewal or contract termination be provided to employees.

#### *Obligation of the Insurer and the Group Sponsor*

The Committee has learned from the Superintendent of Insurance that problems over liability for coverage have arisen in this Province due to the poor definition of the respective obligations of the insurer and the group sponsor in determining eligibility for group coverage and responsibility for notification of loss of eligibility. Included as one radical instance of loss of eligibility is the situation of termination of the group contract. Problems also arise when errors are made in administering the group policy.

The Committee has considered a number of diverse proposals for resolving the current problems, including:

1. Full definition in statute of the conditions for eligibility in group life insurance coverage and statutory requirements for notification of loss of eligibility.

In this case, a person wrongly informed about eligibility or its continuation could hold the group administrator personally liable for the error made.

2. Extension of the incontestability provisions of The Insurance Act to group coverage to include errors made related to eligibility. In this case, eligibility could not be used as a means of avoiding or contesting a claim after 2 years of failure to notify a group member of a change in eligibility.
3. Statutory requirements that the insurer be held responsible for checking the eligibility of each member of the group and notifying each member when coverage ceases. This proposal would impose an administrative burden on insurers.
4. Consideration of the employer or group administrator as an agent of the insurer. In this case, the insurer would be bound by the actions of the group administrator or sponsor.
5. Statutory definition of the joint responsibility of the group sponsor and group insurer to determine eligibility and to notify the group member of termination of coverage. The division of responsibility would be a matter for settlement between the group sponsor and the insurer. Insurers could in this case protect themselves against errors by the group administrator by entering into indemnity agreements whereby the group sponsor is made to indemnify the insurer for errors made by the employer in administering the policy.

The Committee favours the last proposal.

- 6.11 The Committee recommends that the joint responsibility of the group sponsor and group insurer in matters of determining eligibility and notifying group members of termination of coverage or other change in eligibility status be set out in The Insurance Act.

This recommendation should in no way deny the insurer's overriding responsibility to notify group insureds of termination of the contract and their rights to convert to individual plans of insurance.

## **C. CREDITOR'S GROUP INSURANCE**

### **1. Introduction**

Creditor's group insurance is a type of group insurance issued to institutions that lend money or finance the sale of goods. The Insurance Act in Section 145(e) defines creditor's group insurance as "insurance effected by a creditor in respect of the lives of his debtors whereby the lives of the debtors are insured severally under a single contract".

The creditor is both policyholder and beneficiary, and in order that there should at all times be an insurable interest, the amount of the insurance is limited to the outstanding indebtedness of the borrower. In this manner, in the case of a borrower's death, the entire loan is repaid.

The debtor may or may not be charged directly for the insurance premiums at the option of the creditor, who has the master contract. If he is charged, it is referred to as a "specific charge". His contract sets forth premium rates.

## 2. Practice and Costs

Typical of general practice is the following description of the business of creditor's group insurance:

"The business is limited to loans with a maximum period of repayment of three years. The maximum amount on any one life is determined by the total volume of outstanding loans of the creditor effecting the policy. It varies from a maximum of \$1,500 where the total is less than \$150,000 to a maximum of \$5,000 where the total is \$800,000 or more. The insurance company requires 100 per cent participation of all eligible debtors. The premium to cover the insurance risk varies from 50 cents to 70 cents a month per \$1,000 of outstanding debt according to the size of the plan and for the largest cases with millions of debt outstanding the rate is reduced to 45 cents a month."<sup>1</sup>

In recent years, maximum amounts of coverage have been increased considerably, up to \$35,000 in the case of one example brought to the Committee's attention.

A limit is placed on the amount of loan which will be insured in order that the group concept of homogeneity of risk apply. Loans of large magnitude would require that some evidence of insurability be provided or some consideration be given to age or other rating characteristics of insureds. For this reason, residential mortgage loans traditionally have not come under creditor's group life insurance.

The flat premium rates charged for creditor's group insurance are determined arbitrarily in advance based on past experience and are adjusted from time to time thereafter on the basis of the claims experience of the group. No attempt is made to determine either premiums or claims experience on the basis of the individual ages of debtors.

A form of certificate is issued by the creditor when the loan is contracted for. There is, however, no requirement in The Insurance Act for a certificate to be issued as is the case for ordinary group life insurance. The certificate provided at present does not constitute a contract between the person insured and the insurance company.

On selected groups, insurers will add a total disability benefit covering the balance of the instalments payable on the loan in the event of the total disability of the borrower.

1. A. Pedoe and C. E. Jack, *Life Insurance, Annuities and Pensions*, University of Toronto Press, 3rd edition, 1978.

It must be noted that a number of financial institutions, principally credit unions and a number of banks, now sell a type of creditor's life insurance which ensures that the balance of the mortgage is paid by the underwriting insurer to the lending institution if the person who pays the mortgage dies. This coverage is often called "mortgage life insurance" but must be distinguished from decreasing term coverage which is also often sold under the name of "mortgage insurance" and from "mortgage insurance" which protects the lending institution in the event of default by the borrower in paying off his mortgage.

This coverage must also be distinguished from the traditional forms of creditor's group life insurance which are written under a master contract, require 100% group participation and are generally flat rated across all age levels. The residential mortgage insurance sold through financial institutions is optional, although lives may be insured under a single contract; the cost is separately identified; and premiums are typically calculated separately for several age categories of the insured. Applicants for such "mortgage life insurance" may also be required to answer a health questionnaire whereas this requirement does not typically exist for traditional creditor's group life insurance.

### 3. Market Size

At the end of 1978, 53 federally and provincially registered companies had \$30 billion of creditor's group insurance in force in Canada, which was about 14% of the total group life insurance in force. This compares with \$830 million or 11% in 1966, and indicates a tremendous growth in this market.

The five most active companies in the creditor's group life insurance business in Canada are identified below. L'Assurance-Vie Desjardins which has the greatest amount of creditor's group life insurance in force in Canada writes principally in the Province of Quebec. The other 4 companies are major participants in the Ontario market.

TABLE 3  
CREDITOR'S GROUP LIFE INSURANCE—CANADA  
1978 GROSS AMOUNTS IN FORCE

	1978 Gross Amounts in Force (\$ million)	Percent of Total Group <sup>1</sup> Life in Force
L'Assurance-Vie Desjardins	\$5,764	57%
CUMIS Insurance Society	3,446	96
Sun Life Assurance	3,440	15
Canada Life Assurance	3,219	18
Prudential of America	1,719	17
	<hr/> \$17,588 <hr/>	27%

1. Includes world-wide business of Canadian companies.

Source: Report of the Superintendent of Insurance, Ottawa, 1978 and CLIA.



Roughly one half of creditor's group insurance is provided under the specific charge to debtor basis. The Superintendent of Insurance has provided the following data for Ontario for 1977 and 1978.

**TABLE 4**  
**CREDITOR'S GROUP INSURANCE—ONTARIO**  
(\$ millions)

Type of Insurance	Debt Insured		Earned Premium		Premiums per \$1,000 Debt	
	1977	1978	1977	1978	1977	1978
Life—No Specific Charge	\$9,712	\$7,598	\$38.7	\$26.8	\$ 3.99	\$ 3.53
Life—Specific Charge	8,358	9,890	44.3	45.5	5.30	4.60
Disability	2,914	1,820	45.0	31.7	15.44	17.42

*Source:* Office of the Superintendent of Insurance in Ontario.

#### 4. Problems Associated with Creditor's Group Insurance

Prior to 1973, a number of creditors receiving experience refunds did not pass them on to the individual debtors paying specific insurance charges. As this receipt by the creditors could be treated as business income, it led to 'reverse competition'. This meant that creditors selected insurance companies having high premiums in the expectation of receiving high experience refunds.

To prevent such practices, the Superintendents of Insurance of all Provinces issued guidelines applicable to creditor's group insurance, which may be summarized as follows:

1. If a specific charge is levied against the debtor for the cost of all or part of the insurance, it must be disclosed on the application form.
2. If the application form contains questions regarding the state of health for insurance eligibility purposes, a copy of the form must be delivered to the applicant at the time of signing.
3. Where a specific charge is levied against the debtor, the insurance company is not permitted by Ontario guidelines to make an experience refund to the creditor.
4. This refund will instead be used to stabilize premiums payable under the contract.
5. Premium rates in respect of a contract of creditor's group insurance must be established so as to produce a minimum loss ratio.

The guidelines in 1973 prohibiting payment of experience refunds, and the guideline in 1976 establishing a minimum loss-ratio are said to have effectively curtailed the problem of reverse competition. The loss ratio in regard to creditor's group life insurance is defined in a guideline issued on

May 17, 1976 by the Superintendent of Insurance in Ontario to be no less than 80%. The Superintendent of Insurance, in information provided to the Committee, stated that "since the loss-ratio guidelines went into effect, we have noticed a reduction in life premium of as much as 40%. This to our mind is the most positive and significant indication of the present control mechanism".

A Subcommittee of the United States Senate has recently held hearings on credit life insurance to ensure that consumers receive good coverage at a reasonable price. In this regard, it also has considered the implementation of a minimum loss-ratio, as is already required in this Province. Witnesses to the Senate Sub-Committee noted that the average rate for credit life in the United States in 1979 was about \$6.55 per \$1,000 debt.<sup>1</sup> In Ontario, the rate in 1978 varied from \$3.53 for no specific charge, life coverage to \$4.60 for specific charge coverage. Before introduction of the minimum loss-ratio guidelines in 1976, the 1974 and 1975 rates in Ontario for specific charge coverage were \$7.83 and \$7.23 respectively. In view of the reductions effected in Ontario, the Superintendent of Insurance in Ontario in his submission to the Committee stated "... this is one area where we believe we are the leaders in North America".

One matter still of some concern to the Superintendent as stated in his submission to the Committee is the following.

"The statute does not specify any right of action to a debtor, whose life is insured under a creditor's group life insurance contract. This places the debtor or his estate in a disadvantageous position vis-a-vis a group life insured, who may enforce his rights under section 175 of The Insurance Act. In practice, a debtor is required to pay or contribute to the cost of this insurance and he (or his estate) should have a right of action."

## 5. Observations

### *Rules Setting Out a Minimum Loss Ratio*

The Committee has given consideration to incorporating the rules governing creditor's group insurance, as established by the Association of Provincial Superintendents, into insurance regulations in this Province. These rules set out a minimum loss ratio applicable to contracts of creditor's group insurance.

- 6.12 The Committee does not believe that the guidelines governing creditor's group insurance should, for the present time, be incorporated into regulation, although close monitoring of the efficacy of these guidelines should continue through the Office of the Superintendent. The

1. M. J. Fisher, "Threatens Credit Life Standard Bill", *The National Underwriter*, November 17, 1979, pg. 28.

Committee emphasizes that the ongoing responsibility of the Superintendent should be to ensure that charges for creditor's group life insurance, whether of a specific or non-specific nature, are at the lowest possible rates.

### *Rights of a Debtor Under Creditor's Group Insurance*

In regard to the Superintendent's comments about the lack of rights of a debtor insured under a creditor's group life insurance contract to take legal action against the insurer, the Committee believes that the debtor's and his dependants' rights of action should be defined against the creditor rather than against the insurer, and that such recourse to action is already available under common law. Therefore the Committee does not recommend that the debtor or his estate be placed in the same position as a group life insured or that The Insurance Act be amended in this regard.

### *"Mortgage Life Insurance"*

It has been brought to the Committee's attention that financial institutions selling so-called "mortgage life insurance" are potentially in a position of coercive influence on consumers applying for residential mortgage loans. That is, because such institutions may refuse to grant mortgage loans unless this type of insurance is purchased, the borrower may be placed in a position of having no choice but to buy this coverage from the mortgage lending institution offering the loan. This restricts the ability of the consumer to price shop and hence restricts competition.

6.13 The Committee recommends that life insurance companies licensed in this Province be prohibited from selling life insurance related to the outstanding debt on a residential mortgage loan if the borrower is restricted by the lending institution in his choice of insurer, to the insurer with which the mortgage lender customarily does its business. Financial institutions failing to advise borrowers that mortgage life insurance can be obtained from the borrower's choice of insurer and to identify its cost separately to the mortgage borrower should be placed in the position of contravening the provisions of The Business Practices Act or appropriate legislation. The Committee recommends appropriate amendments to both The Insurance Act and The Business Practices Act.

## **D. GROUP PENSIONS**

### **1. Group Pensions and the Role of the Life Insurance Industry**

Pensions are income payments provided for life or for a fixed period in exchange for services rendered by an employee or as a grant by a government to its citizens. Employee and employer funded pensions under group plans are considered here, both in the public and private industry sectors;

government funded pensions are excluded from this discussion. Participation of paid workers in group pension plans across Canada has increased from 39.2% in 1970 to 44.1% in 1978.

The life insurance industry has shared in the growth in the group pension market. It has extended its coverage of group plans in that 72.6% of all *plans* were funded with insurance companies in 1978, compared to 68.5% in 1969/70.

However life insurance companies have a relatively small share of the group pension market in terms of number of members and the amount of funds collected. In 1978 in Canada, only 13.0% of all group pension plan *members* were covered by life company plans and only 10.2% of the amounts of funds contributed were in the hands of life insurers. These latter two statistics reflect a decline from 14.2% of members and 13.1% of funds in 1969/70. As the percentages quoted relate to the total group pension market, including the massive public sector plans, it is evident that the participation of insurers in private sector plans is much higher. It appears in fact that the pension business of life insurers is concentrated on smaller plans, and on lower benefit plans, as indicated by the lower proportionate share in funds contributed than in plan members. It appears that life insurers are losing business in the larger plans, as they are covering more plans but with fewer members.

Despite a small share of the group pension market in terms of number of members, expansion of the group pension business of life insurance companies has been most impressive. Premium income for group annuities amounted to \$1,188 million in 1978 compared to \$311 million in 1970.

In comparison to individual annuities, the \$1,188 million in premium insurance for group annuities compares to \$801 million for individual annuities in 1978. Group annuities now account for some 60 percent of the group business of life insurers compared to 49 percent in 1970. In 1978 Canadians owned 544,000 group annuity certificates, compared to 563,000 individual annuity contracts. Variable contracts and figures for deposit administration contracts are excluded from this comparison.

### *The Payout and Funding of Group Pensions*

In their narrow definition pensions refer only to the payment of income over time, but in a broader sense in discussing the pension system consideration must be given to the funding of pensions. Neither the funding nor the payout of group pensions need be carried out through a life insurance company.

With respect to group pension payout, the objective of the pension plan is to provide an income stream at retirement, and hence legislation does not normally permit the payment of a cash settlement instead of a pension. The



normal form of pension under a non-contributory plan is a life annuity. Under contributory plans, various other options are usually available such as life annuities with term certain guarantees, joint and last survivor annuities, and variable annuities. It is sometimes required for these additional options that the employee elect an option up to five years prior to retirement, to avoid selection against the plan. A member of a plan who meets specified conditions and withdraws from a pension plan or terminates employment is entitled to a deferred life annuity commencing at his normal retirement age. For the most part he is prohibited by legislation from surrendering or commuting his rights under the deferred life annuity contract.

There are no data readily available to indicate to what extent pensions are provided for life and to what extent they are provided for a period certain. However, if the pension is to be provided in the form of a life annuity, it becomes necessary for the employer to turn to a life insurance company and purchase a group life annuity contract. This can be purchased on a deferred basis or an immediate basis depending on the employee's circumstances. As it appears that life pensions are commonly provided, life insurance company participation in the payout stage of pensions appears to be quite significant. The guarantees of payment for life which are provided by the insurance company in a group life annuity cannot be obtained through any other method of providing pensions.

With respect to pension funding, employers are free to choose a method of funding within the solvency restrictions of The Pension Benefits Act. Numerous methods of funding are available to employers, only one of which is the funding of the plan through a group deferred annuity contract purchased from a life insurance company. As a result, life insurance company participation in the funding stage of pensions is limited. Smaller groups are the main market for pensions funded through group annuity contracts offered by life insurance companies. For larger groups, insurers provide instead a variety of services related to pension funding, without providing a group annuity contract.

### *The Pension Products and Services of Life Insurance Companies*

In sum, insurance companies extend their services in the pension area in a number of ways, including:

- group annuity contracts;
- individual policies, primarily immediate annuities sold through group accounts;
- deposit administration; and
- variable or segregated investment funds.

*Group annuity contracts* are the most important form of insured pension plan, accounting for about 60% of pension plans funded through life companies. Under a group annuity plan, employer and employee contribu-

tions are applied to the purchase of a deferred annuity. At retirement the employee is provided with a monthly income based on the total of the amounts accumulated for him under his annuity plan. Typically, the employee is allowed free choice of the type of annuity he wishes for payout of income.

Under a deferred group annuity contract, the insurance company guarantees an amount of pension which will be available for retirement and it guarantees further the regular payment of a monthly annuity. The supervision of life insurance companies for solvency ensures that they meet their obligations. It has been said of non-insured plans that "many do not have sufficient assets in the event that the sponsoring organization were suddenly to cease operation".<sup>1</sup>

It is now common for premiums on group annuity contracts to be calculated using investment yields currently attainable, rather than the overall rate on the company's total assets.

*Individual annuity policies* are also sold to group accounts. Individual policies are primarily immediate annuities bought for an employee when he retires or terminates employment, out of funds accumulated under non-insured pension plans. As noted earlier, when an employee or employer chooses a life annuity, it must be purchased through a life insurance company. The discussion of individual life annuities and immediate annuities in Chapter 5 applies fully to similar products sold to group accounts.

*Deposit administration contracts* are a compromise between deferred group annuity plans and self-administered trustee pension plans. Contributions accumulate in a deposit administration fund until needed to purchase an annuity for an employee when he retires. The employer assumes responsibility for the adequacy of the fund by making appropriate contributions to the fund.

Under a deposit administration contract the insurance company may provide actuarial services in the form of recommendations by the insurance company's actuary as to the amount of the deposit to be made by the employer. Periodically the experience of the plan is reviewed and the recommendation regarding size of deposits is revised.

In addition, the insurance company guarantees the annuity rates which are used when an employee retires and it also guarantees the integrity of the principal of the fund. The insurance company credits interest to the pension fund on either an "average interest rate" basis or a "new money rate" basis, the latter being most common today except perhaps for smaller groups.

*Segregated investment funds* permit employers who hold either group annuity contracts or deposit administration contracts to share in the invest-

1. Second Report of the Ontario Committee on Portable Pensions.

ment experience of a common stock fund or other class of investment fund segregated from the general assets of the company. These funds provide employers with a wider choice of funding pension plans, but without some of the guarantees provided by participation in the overall investment experience of an insurance company. Life insurance companies nevertheless continue to provide a guarantee related to the mortality element under the pension plan, an advantage not available when trust companies are the funding agencies.

In addition to and including the above products and services, life insurance companies provide the following *range of services*:

- design of pension plans;
- calculation of the cost of pension plans;
- assistance in securing government approval;
- help in setting up payroll deduction records and other record-keeping;
- investment of funds;
- other actuarial services; and
- payment of benefits.

## **2. Investigations into the Pension System**

Extensive study has recently been undertaken in the field of pensions. The Ontario Royal Commission on the State of Pensions will report in June of 1980 and a study for the federal Department of National Health and Welfare will soon be released. In November 1979, the Economic Council of Canada released its report titled: "One in Three: Pensions for Canadians to 2030". In December 1979, a special Senate Committee, chaired by Senator David Croll, issued a report on Canada's pension system, titled "Retirement Without Tears".

These studies have and will be addressing fundamental issues in the pension field, including:

- the role of government pensions;
- legislation pertaining to private group pension plans as well as individual pension plans;
- tax-deferral and other incentives for pension funding;
- the role of private institutions, such as the insurance industry, in the pension field;
- contribution and benefit limits;
- eligibility and pension age;
- equality and equity in funding and payments;
- vesting;
- portability;
- the effects of inflation on pensions;
- member awareness about the terms of group pension coverage;
- actuarial and solvency requirements for private plans.

The life insurance industry will be responding to these issues and to the recommendations made in the studies on the pension system. It will also be responding to any forthcoming changes in a number of statutes which pertain to the pension system, including The Pension Benefits Act and The Employment Standards Act in Ontario as well as the Human Rights Code.

6.14 In the light of a number of recent studies concerning the adequacy of the pension system in Canada and in this Province and the special statutes covering pension matters, the Committee's intent in this Report is to ensure that life insurance companies are recognizing their responsibility to improve the products and services available in a *private* system of benefit protection, rather than to address the full spectrum of issues in the pension field.

The following section therefore looks at the response of life insurers to a number of significant pension issues.

### **3. Response of Life Insurers to Pension Issues**

Every responsible employer is likely now expected although not obligated to provide pensions for his employees. While most large plans tend to use trust arrangements to fund their pensions, most small plans tend to use insurance companies as the funding agency. It would seem therefore that every responsible life insurance company selling group pensions and service might now be expected to assure all groups, whatever their size, that the basic features of the pension plans they offer protect the employees well and do not sacrifice protection in order to save money for the employer.

6.15 It is particularly important, in the Committee's view, that life insurers pursue improvements in pension plans *on behalf of* the smaller group plans which tend to use insurance companies as their primary funding agency and rely on the insurers as the experts in pension advice.

It is of particular concern to the Committee that smaller groups not be put at a disadvantage relative to larger pension fund groups in the insurance companies' calculation of the investment yields applicable to group pension contracts. The Committee is informed that it is common practice for insurers to credit investment earnings to larger pension groups on a "new money rate" basis and to the smaller pension groups on an "average interest basis", the latter being the overall rate on the company's total assets. This practice is in the Committee's opinion discriminatory against the smaller groups.

6.16 The Committee recommends that insurers should undertake to treat all pension groups alike in computing investment yields and for purposes of dividend distribution, unless specific segregated funds are set up for individual pension groups.



The Committee comments again on the matter of dividend distribution in regard to individual policies in Chapter 8 of this Report.

It is the Committee's further observation that the responsibilities of life insurance companies in the field of pensions can only be carried out if life insurers look to the needs of employees as well as to the requirements of employers. As a result, life insurers should be addressing themselves to the problems in the private pension system and taking initiatives in areas where their efforts may lead to improvements without the need for government intervention.

6.17 Particular areas in the pension field, where the Committee sees an urgency for industry initiatives, especially on behalf of the smaller group plans, include:

- portability of pensions;
- pension indexing and flexibility to cope with the effects of inflation;
- understandable information about the terms of group coverage provided to each individual group member; and
- adequacy in funding of pension plans and initial and ongoing disclosure to group members concerning fund adequacy.

Brief commentary on the above matters follows.

### *Portability*

The life insurance industry has tackled the challenge of providing portability of pension service from one private pension plan to another with the Portable Pension Pilot Project developed by the Canadian Life Insurance Association.

Under this portability system, any employer can provide an employee with the right to take at least part of his or her pension service to another employer, provided that employer is willing to accept it, or to bring pension service from another employer. This concept is significantly different from the concept of vesting. The Committee was able to examine the details of this plan as they were provided in the CLIA's submission to the Committee.

Fifteen insurance companies have agreed to incorporate the portable pension concept in their own staff pension plans to demonstrate its effectiveness. The system is not experimental and is available now for use by anyone who is interested. The effort of the life insurance industry in regard to a method of making pensions portable is commendable.

### *Coping with the Effects of Inflation*

Further efforts are required in critical areas such as the indexing of pen-

sions to the cost of living. In this matter and in the matter of flexibility in plan design, the comments in Chapter 5 on individual annuities apply equally well to group annuity contracts. The Committee stresses that the matter of flexibility should be emphasized as a special area of concern for life insurance companies in the current inflationary environment. As one response toward designing pension plans in an inflationary environment, the Committee urges life insurance companies to design the annuity payout options offered at maturity of a pension plan on a participating basis that will benefit the plan participants over the payout period.

### *Information on Pension Plans*

The Pension Benefits Act in Ontario requires that every employer provide to each employee who is eligible or is required to become a member of a registered pension plan, with a written explanation of:

- the terms and conditions applicable to him or her;
- the rights and duties of the employee;
- any amendments to the plan which affect members and eligible employees;
- the benefits to which the member is entitled upon termination of employment or termination of membership, these benefits being an immediate or a deferred annuity.

The Committee believes that the insurer should share in the responsibility for providing this and perhaps other needed information to the group member. Especially in the case of smaller groups, the quality and understandability of available information depends on the initiative of the insurance company who provides either a group annuity contract or other services to the pension fund.

The Committee's view is that information provided by the insurer through the employer should be timely, responding to changes in an employee's status in the plan, and also ongoing, providing perhaps annual review of benefits and coverage. Information provided by the insurer should also be comprehensive, providing not only an explanation of available benefits but also a statement of expected benefits in the future and a confirmation of the solvency or adequacy of the funding of the plan. The information should be such that it assists the employee in determining whether he needs to supplement his group pension with a private pension plan.

### *Adequacy in Funding of Pension Plans*

In many cases, the life insurance company acts not only as the funding agency for a pension plan but also as the purveyor of other services in connection with the plan. When viewed from the perspective of the needs of a member of the group for products "that meet needs", and security that

promised benefits will be paid, it would seem that a more specific responsibility for diligence and indeed leadership in the pension field might be considered to lie with the insurance industry.

There is unquestionably an added onus placed on the insurance company and in particular the actuaries of the company when they act in a consulting role concerning the design, reporting and other matters relating to a particular plan.

Frequently an employer, as noted particularly a small employer, wishing to establish a group pension will rely on the services of an insurance company's staff to design the plan, to determine the appropriate funding program for the plan and to assist them in providing details of the plan for brochures and other documents provided to employees. The employees' only knowledge of the pension plan is likely to be from information provided at a meeting held when the plan is first introduced and from data contained in the brochure summarizing the plan.

Because the employees are not normally involved in any way with the design of the plan and the funding requirements that have been negotiated by the employer and the insurance company, they are forced to accept on faith that the plan has been designed to meet their needs and that promised benefits will be paid.

The Committee anticipates that the Royal Commission on the State of Pensions in Ontario will have more to say on the subject of adequacy in the funding of pension plans. The Committee, on its part, addresses the following observations to the life insurance industry and to the actuarial profession:

1. The Committee sees a vital need for initial and ongoing disclosure to employees concerning the adequacy of funding of group pension plan benefits. The Committee urges the insurance industry to take initiatives in this field.
2. The Committee believes that a separate responsibility falls on actuaries as a profession designated under The Insurance Act and The Pension Benefits Act as solely qualified to report on the adequacy of funding for the unmatured obligations of life insurance companies and pension plans. As a profession, actuaries should undertake to improve the methods by which they ensure the adequacy of funding of benefits and are urged by the Committee to develop a generally accepted actuarial basis of valuation of pension plans.

The Committee makes further reference to the role of the actuary in Part VI of this Report.

#### **4. Summary Observations on Group Pensions**

The Committee recognizes, particularly in the pension field, that the insurance industry is but one participant in the group income protection system. Therefore the consumer needs identified in this Report should be met *throughout* the financial protection system. The Committee expects that the Royal Commission on the State of Pensions in Ontario will address similar concerns to those addressed by this Committee in a wider context than the life insurance industry alone. Yet, despite the need for improvements throughout the system of group income protection, the Committee feels that the life insurance industry should not excuse itself from carrying out needed reforms or improvements on its own initiative.





## PART III

### THE COST OF INDIVIDUAL LIFE INSURANCE



## CHAPTER 7

### The Underwriting Process in Individual Life Insurance

#### A. INTRODUCTION

In this Chapter the Committee examines the underwriting process, as a topic essential to understanding the price paid by the policyholder for individual life insurance. The Committee looks in this Chapter at risk classification, the steps in the underwriting process, factors used in risk determination, sources of data on life expectancy and finally privacy and use of personal information.

#### B. RISK CLASSIFICATION

The underwriting process involves, as its most important function, the identification and evaluation of characteristics which affect longevity. This function is known as risk classification.

The Canadian Life Insurance Association presentation to the Select Committee states that:

“The essence of private life insurance and life annuity plans is that they are risk sharing arrangements. With life insurance the risk is of dying prematurely, with life annuities it is of outliving capital. An individual who purchases an insurance plan pools his own risk with the risks of other individuals. Each receives protection at a cost which depends primarily on the expected cost of benefits for the entire pool. In order that the cost may be apportioned equitably among those who choose to participate, an assessment must be made of the degree of risk which a person adds to the risk pool. This assessment involves identifying those characteristics which significantly affect longevity, that is, it involves ‘classification’.”

#### 1. Broad Classes of Risk

The longevity of each applicant determines the risk to the insurance company involved in issuing coverage and thereby determines the premiums payable by the applicant. Rather than assess individual premium rates for each applicant, the underwriting process classifies life insurance applicants into three broad classes—standard, substandard and uninsurable. A definition of these classes follows:

“Those lives insured accepted by a life insurance company at its normal or standard rates and conditions are called *standard risks*. Those lives insured who for any reasons, including those of health, personal, family or medical history, or occupation, are accepted on special



terms are called *substandard risks*. . . . At the extreme is the class who may not be acceptable on any term and who may be called “*uninsurable*.”<sup>1</sup>

A range of risks is included in each broad class. However, only in the middle or substandard class do insurers distinguish among risks in setting premiums. For example, the substandard class may include degrees of risk from marginally substandard to severely substandard, with corresponding rate differences.

The prime objective in establishing classes of risk is the equitable treatment of all policyholders. By separating substandard and non-insurable risks from standard risks, the normal or standard lives are not required to bear the cost of insuring those whose life expectancy is very short. Similarly, by distinguishing among substandard risks, it is the objective that a non-standard class of policyholder neither subsidize nor be subsidized by any other non-standard class.

## **2. Risk Factors**

In order to classify risks as standard, substandard, or uninsurable, the process of underwriting is interested in determining which characteristics of a person are related to longevity and conversely which are related to early mortality. These characteristics are known as risk factors. The risk factors used by those responsible for underwriting applicants for life insurance are numerous and vary by company. For purposes of this Report, they are grouped under the headings of age, sex, medical impairments, occupation, avocation, aviation, and lifestyle. Each of these will be discussed in detail later in this Chapter.

## **3. Assessing the Relationship Between Risk Factors and Mortality**

There is no single method used by actuaries and underwriters to determine which risk factors should be taken into account in risk classification. Rather, there is a number of methods. At one end of the spectrum are objective approaches toward determining the relationship between risk factors and mortality. At the other end of the spectrum are purely judgmental assessments of factors which may have a bearing on longevity. Because of this broad array of risk assessment methods, underwriting itself has been termed to be risk taking. It has also been described in the following terms:

“Underwriting is both a science and an art. As a science, it makes use of insurance experience, studies of clinical medicine and population statistics by applying them to the situation of a particular individual while recognizing the changing social and economic conditions

1. A. Pedoe and C. E. Jack, *Life Insurance, Annuities and Pensions*, University of Toronto Press, 3rd edition, 1978.

that prevail. As an art, it involves a large element of judgment in determining proper classification by degree of risk.”<sup>1</sup>

A further aspect of underwriting should be mentioned in the discussion of methods of determining longevity. The underwriter and actuary seeking sources of information must rely on statistics which relate to experience totally in the past. On the other hand, the risks that they propose to insure will exist totally in the future. It is therefore necessary for the actuary and in turn the underwriter to interpret past experience as a guide to the future, based on their judgment. Here again, underwriting becomes something of an art as well as a systematic science.

### **C. STEPS IN THE UNDERWRITING PROCESS**

In general, insurance companies follow these steps in the underwriting process:

1. They seek information about the personal risk characteristics of the applicant from a number of sources.
2. They attempt to evaluate the degree of risk associated with the application, often by categorizing applications into various levels of risk.
3. They determine the appropriate premium to be paid from one or a set of premium tables.

#### **1. Collection of Data on Applicants**

The types of information collected by insurers about life insurance applicants, the sources from which this information is collected, and also the privacy and confidentiality of this information once it is gathered, are all topics which will be outlined in greater depth in following sections.

#### **2. Methods of Evaluating Risk**

Upon the filing of an application for life insurance, insurers must evaluate the degree of risk associated with the application, based initially on the information provided on the application form. Most companies employ a method of screening applications quickly based on broad criteria, such as amount of insurance required compared to income level of the applicant, age, occupation and so on to identify those applications which are likely to be accepted, rated or declined. This screening process is also designed to identify those application requests which might result in an early policy lapse. As a result of this screening process, some applications may be immediately declined, although as will be indicated later, relatively few formal applications are denied by life insurance companies in Canada.

1. Submission to the Select Committee on Company Law by the Canadian Institute of Actuaries, September 1979.

It is perhaps worth noting here that not all applications for insurance are submitted formally to insurers to follow through the full process of underwriting before the applicant is accepted, at some premium rate, or rejected. Many life insurers advise their agents to submit informal applications when they suspect a risk factor in an applicant that could lead to denial of coverage. In such cases, agents query their companies about the acceptability of the prospect for insurance without submitting a full application. Depending upon the reply, the agent may continue with the application or advise the prospect that coverage will have to be sought elsewhere. The Committee has found that the circumstances in which some companies may require an informal or a preliminary application to be submitted include:

1. Applicant has been declined or rated recently or in the last 5 years.
2. The agent has some reason to suspect the applicant may not be accepted as an insurable risk.
3. Applicant is over age 65.
4. Applicant intends to take up residence in a tropical country.
5. Existence of specific medical considerations including:

alcoholism	epilepsy
cancer	insanity or psychosis
cerebral palsy	mental deficiency
diabetes	
6. Persons who are in hospitals, sanitoriums, rest homes, prisons or other institutions.

When a formal application is submitted and initial screening of the application identifies the applicant as potentially a substandard risk, most life insurance companies use some variation of a “numerical rating system” in an attempt to evaluate such risks more consistently. Rating systems of this type give the average risk a numerical value of 100%. Factors considered as favourable in the judgment of the company are identified as credits and are deducted from 100% and unfavourable factors are identified as debits and are added. Certain factors are interrelated, and are considered in conjunction with each other. These are given joint debit ratings in addition to their individual ones. The ratings given to risks vary according to the severity of the risk, and from company to company. The summation of these factors will then determine into which risk classification the applicant fits—that is, standard, one of a number of substandard categories or uninsurable. Insurance companies establish their own individual category limits. Systems of this kind are generally applied on rated cases, but insurers may defer the final categorization of an applicant for an overall review of the risk.



In most cases, using methods such as the numerical rating system, an underwriter can categorize uncomplicated applications within certain limits, which vary from company to company. In complicated cases, a senior underwriter and perhaps a medical director will become involved. Certain other applications will be reviewed by a selection committee composed of a doctor and several underwriters. Every application declined on medical grounds is reviewed by a medical director.

### **3. Setting Premium Rates Based on Risk Categorization**

In setting premium rates for the insured lives, many companies develop a number of premium tables, one of which corresponds to the mortality experience of standard risks with others corresponding to the mortality experience of selected subclasses of substandard risk. Other companies use a single premium table related to standard risks at different ages and, for each characteristic or group of characteristics which affect longevity, the company determines an appropriate age add-on to the standard table, which in effect results in a higher premium being charged to the insured. A combination of the two methods may also be used.

The extra premium charged for substandard risks may be temporary or permanent, may be level or change over time, or may vary not only according to the period of time after the issue of the policy, but also in relation to the age of the applicant at the time of the issue of a policy. A recent innovative approach announced by one insurer in regard to premiums for substandard risks has been to set a separate high-risk mortality premium to be paid in addition to the standard risk premium, with refund of the high-risk premium component promised after 10 or 15 years if the policyholder is still alive. Premium payments beyond the 10 or 15 years would continue at standard rates.

### **4. Industry Experience with Respect to Rating of Risks**

The CLIA reports from a survey of its members writing across Canada that two percent of individual applicants were denied basic life insurance coverage in 1977 and a further four percent were rated substandard. These numbers do not include those enquiries about coverage submitted informally. The CLIA Survey is based on a total of 855,611 applications estimated at about 70 percent of applications written in 1977. A breakdown of the total applications surveyed is shown in Table 1.

Of those declined, 32 percent were rejected because of heart disorders, 46 percent because of other serious health problems and the rest for other reasons. One-fifth of one percent were turned down because of dangerous occupations.

Of those rated substandard or extra-risk, 27 percent were rated be-



**TABLE 1**  
**CLIA SURVEY OF LIFE INSURANCE**  
**APPLICATIONS—1977**

<b>Applications</b>	<b>Number</b>
Number issued and paid for	
—rated as standard	775,917
—rated as substandard	29,523
Number declined by companies	16,519
Number not taken by applicant	33,652
<b>Total</b>	<b>855,611</b>

*Source:* Canadian Life Insurance Association

cause of heart disease, 13 percent because of weight problems, 36 percent because of other physical impairments, 13 percent because of dangerous occupations and 11 percent for other reasons.

LIMRA, for the first time, in "The 1978 Buyer Study—Canada", examined policies on insureds considered to be "extra risks" and found that only 4% of policies sold by the 29 companies in its survey were "rated". The results of LIMRA'S survey are as follows:

**TABLE 2**  
**SALES OF RATED AND STANDARD**  
**POLICIES BY ALL AGENTS**  
**(ADULT MARKETS)—1978**

	<b>Distribution of</b>			<b>Average</b>	<b>Premium</b>	<b>Premium</b>
	<b>Policies</b>	<b>Premium</b>	<b>Volume</b>	<b>Size Policy</b>	<b>Per Policy</b>	<b>Per \$1,000</b>
<b>All Adults</b>						
Rated	4%	6%	4%	\$26,930	\$446	\$16.50
Standard	96	94	96	29,460	304	10.30
	100%	100%	100%	\$29,350	\$310	\$10.60
<b>Rated Policies</b>						
Male Lives	77%	87%	85%	30,630	493	16.10
Female Lives	23	13	15	14,750	290	19.60
	100%	100%	100%	\$26,930	\$446	\$16.50

*Source:* LIMRA, The 1978 Buyer Study-Canada.

Given this brief background on the underwriting process, this review turns to a more detailed examination of the risk factors assessed by insurers in rating applicants for life insurance.

## D. FACTORS USED IN RISK DETERMINATION

The factors used by insurers in risk determination can be grouped under the following headings:

- age
- sex
- medical impairments
- occupation
- avocation
- aviation
- lifestyle.

In determining the premium for a policy, insurers have to rely on only one mortality table relating to the sex and age of the applicant. That is, in regard to the first two categories of risk factors, age and sex, there is no non-standard classification as the premium rates by age and sex are by definition the standard rates. In regard to the remaining five categories, a wide variety of factors within each result in an applicant being classified as a nonstandard risk.

General observations on each of the broad risk categories are set out below. The Committee will comment on the use of these categories for rating risks in its observations later in this Chapter. Further commentary on the sources of mortality data to support differential ratings follow later.

### *Age*

After the onset of adolescence, one's life expectancy decreases as one gets older. It follows therefore that age is one of the factors taken into account when issuing a life insurance policy and setting the premium—the older the applicant, the higher the premium rate.

### *Sex*

Mortality tables demonstrate the greater life expectancy among females relative to males of the same age. As the probability is greater that a man will die in the following year, it is held by the life insurance industry to be reasonable that he should pay a higher premium than a woman in order to obtain the same amount of life insurance.

This is in marked contrast to the early days of life insurance in Canada, when childbirth and other factors reduced female life expectancy so that an extra premium was required on female lives, and some companies declined them altogether.

### *Medical Impairments*

The medical history of personal illnesses, impairments and operations

of each applicant is considered in the risk classifications process, as these may have an influence on longevity. Temporary impairments are rated only if recent. Cured impairments, with no recurrence, are rated differently from existing impairments, and are considered less likely to influence longevity.

The medical examination taken at the time of application, or the non-medical declaration signed in its place, is designed to provide the underwriters with information relating to the general health and to the cardiovascular, respiratory and digestive systems of the applicant. The medical examination also provides information from a blood pressure test and an urine analysis. As good health, and thus longevity can be impaired as a result of an illness that damages the proper functioning of a part of the body, these data are used to classify risks.

On the grounds that hereditary family traits and illnesses can influence longevity, details of family medical history are requested from applicants. This information is then taken into account in the risk classification process by most companies. A family history of heart problems, for instance, would probably lead to an applicant being rated substandard.

Not many years ago, racial origin was a "medical" factor taken into account in underwriting life insurance. Non-whites were subject to "race extra" premiums and/or were restricted as to the type of policy available to them. The assumption behind these restrictive practices was that non-whites, due to various environmental factors, experienced a shorter life expectancy than whites. Changes in the social environment and a general advance in the understanding of the related mortality statistics led to the disappearance of these practices.

Examples of selected medical ratings found by the Committee to be included in company underwriting manuals are listed in Appendix E.

### *Avocations*

Certain avocations, such as scuba diving, hang-gliding and motor racing, are considered dangerous and therefore classified as risks requiring an additional premium. As many of these forms of recreation are relatively new, the longevity experience related to them may not yet be statistically evaluated, and companies will either apply experimental ratings, or offer policies with exclusion clauses relating to these activities.

Should these sports be engaged in professionally, a far more serious risk has to be assessed, due to the full-time exposure of the hazard.

Examples of selected avocational ratings found by the Committee to be included in company underwriting manuals are listed in Appendix E.

### *Occupation*

Occupation may be a fundamental factor in a person's probable future

life expectancy. Certain occupations can create unfavourable health conditions and others are potentially hazardous. Occupation is therefore a factor considered by insurers in determining risk.

Improved living and working conditions over the last thirty-five years have led to an improvement in life expectancy, and this has been recognized in the life insurance industry in recent years by a considerable reduction in the number of occupations for which an extra premium is required.

Examples of selected occupational ratings found by the Committee to be included in company underwriting manuals are listed in Appendix E.

### *Aviation*

Aviation is a risk factor which overlaps the occupation and avocation categories. The Society of Actuaries statistics indicate that a minimal amount of excess premium will cover the risk involved of flying on scheduled airlines anywhere in the world, and in an effort to standardize as many premiums as possible, no excess premium is charged. As mortality experience relating to non-scheduled fare flights and company-owned plane flights has shown improvement in recent years, the extra premium for this also is generally ignored.

Practices relating to civilian pilots vary. For instance, pilots and crew of major North American airlines operating passenger planes from a North American terminal are generally taken at a standard risk. However, inexperienced private pilots will either be charged an extra premium, or be offered an aviation exclusion clause, which restricts in some manner the amount payable in the event of death due to engaging in aviation.

### *Lifestyle*

Numerous factors related to lifestyle may be considered by insurers in the risk classification of applicants. Some of the factors brought to the Committee's attention include:

- travel,
- use of alcohol, drugs and tobacco,
- moral character,
- certain aspects of one's social environment,
- associates, and
- criminal record, where applicable.

Other factors, on the positive side as indicative of longer life expectancy, such as regular exercise, do not as yet appear to be given consideration in underwriting.

Brief comments on the first two factors follow. Examples of selected lifestyle ratings found by the Committee to be included in company underwriting manuals are listed in Appendix E.



### *a) Travel*

Shorter life expectancy is expected in tropical and semi-tropical climates as compared to temperate climates. Residents of certain countries experience a shorter life expectancy not only because of climate conditions but because of poor public health standards, poor sanitation, altitude, social life and political background. All these potentially shorten longevity, but "all policies issued in Canada are free from restrictions as to residence and travel provided they are taken out when there is no indication or likelihood of residence in or travel to areas requiring an extra premium. Such policies would remain in full force in the event of such residence or travel subject, of course, to the payment of the regular premium".<sup>1</sup>

This contrasts with underwriting practices in the late 1800's, when insurance companies specified in the policies where a policyholder could travel.

### *b) Alcohol, Drugs and Tobacco*

The following excerpt from the Mutual Life Assurance Company's presentation to the Committee summarizes the industry's approach to alcohol, drugs and tobacco:

"Habits include alcohol, non-medically prescribed drugs and tobacco. Clinical and industry studies show increased mortality where alcohol consumption is sufficient to be criticized by one's peer group, to affect employment or family life, or to require medical treatment.

The non-medical use of drugs, and in particular "street" drugs and heroin, does result in increased mortality in the user population. While the infrequent social use of marihuana may be disregarded in the adult population, heavier use is considered significant.

The effects of smoking of tobacco on health have been well established in recent years, and this factor is included in our consideration. We do not charge extra premiums for smoking alone, but we do increase extras where the applicant who smokes is rated for certain other impairments, such as cardiovascular or respiratory problems. On the other hand, such extras would be reduced if the applicant did not smoke."

## **E. SOURCES OF DATA ON LIFE EXPECTANCY**

To establish a proper perspective for the use by insurers of the above-mentioned risk factors in pricing, consideration must be given to the sources of data on life expectancy. These are reported to be:

— studies conducted within a company on its own policy records,

1. A. Pedoe and C. E. Jack, *Life Insurance, Annuities and Pensions*, University of Toronto Press. 3rd edition, 1978.

- studies by professional actuarial associations of industry experience,
- information published as a result of medical research, and
- reports prepared by government agencies and other sources.

Information provided to the Committee on these sources of data has been adapted to the following brief overview.

## **1. In-House Studies**

The large insurance companies rely on studies of their own policyholders to determine the match or mismatch between their actual mortality or morbidity experience compared to the assumptions used to set premiums. Companies normally do not have much difficulty comparing the ratio of actual experience to expected experience for their standard insurance, but only larger companies will have an adequate number of policyholders insured for a specific risk factor or a specific impairment, such as duodenal ulcers, to be able to measure the experience for that specific factor. In-house studies have the advantage that all policyholders have been subject to relatively consistent underwriting standards.

## **2. Inter-Company Studies**

Few companies, however, have sufficient experience on the rare risk factors or impairments to be able to produce a valid measurement of the extra risk. It is by bringing together the experience of a number of insurers in a given market that it is possible to generate enough experience on an uncommon risk factor to produce statistically valid results. The process of conducting inter-company studies is described further below.

## **3. Clinical Studies—Medical Impairments**

Because an inter-company study is a rather large undertaking which can only be done at certain intervals and at considerable expense to the contributing companies, most companies attempt to keep abreast of current developments in medicine by staying aware of medical studies of mortality or morbidity experience of particular impairments. The difficulty in using the results of these studies is related to the extrapolation of credible data from the experience of a group of medically impaired people to that of a group of relatively healthy applicants for insurance. There is also a problem that such studies are normally of relatively short duration whereas insurance can extend for many years. Also, the results of clinical studies are expressed in ways which are not immediately applicable to ratemaking. Nonetheless, such studies are an important source of information regarding current developments which enable the underwriter to make a more accurate projection of future mortality than merely following a statistically credible, but outdated, mortality study.

## 4. Other Sources

In his search for statistics, the underwriter will seek information from other sources which might provide guidance. For example, various government agencies in Canada and the United States measure the experience of impaired lives in hospitals and in other institutions. In addition, studies from foreign actuarial or insurance organizations can be of value and are often communicated through professional reinsurers.

## F. INTER-COMPANY STUDIES

The process of conducting inter-company studies is sufficiently interesting to warrant additional comment.

There are two main organizations responsible for research in the selection and classification of life insurance risks. These are the Society of Actuaries and the Association of Life Insurance Medical Directors of America. Both of these organizations span Canada and the United States.

Because individual underwriting is of mutual concern to the medical director and the underwriting actuary of an insurer, the bulk of the research work in this field is directed by a so-called Liaison Committee made up of three members of the Society and three members of the Association. The Liaison Committee in turn creates working groups to handle specific projects.

The procedure for studying experience is now fairly well established within the insurance industry. All companies which might have the capacity to contribute data to a special study are asked if they will do so and are sent a copy of the detailed specifications of the study.

These records for each of the contributing companies are sent on computer tape to the compiling organization for amalgamation. In past years, one of the major companies would normally have acted as compiler, but more recently the industry has used the Centre for Medico-Actuarial Statistics, which is an affiliate of the Medical Information Bureau. This has had the advantage of developing continuity through a permanent organization rather than shifting such jobs from company to company, and has the further benefit of spreading the cost of the study equitably across the industry.

The process is then fairly routine for a larger computer. The records for individual risk factors or specific combinations of risk factors are isolated and a number of calculations are made to determine the rates of claim that were experienced while the policies were under observation. A calculation is made of the number of deaths which would have been expected had the policyholders been considered as standard risks. Then a comparison is made between the actual number of deaths and the expected number of deaths. If the so-called risk factor does not in fact produce any significant extra mortal-



ity, this ratio will be in the area of 100%. If, however, the risk factor does represent an extra risk, the ratio could be 200%, 500% or 1,000%.

It is not only the magnitude, but also the incidence or pattern of extra mortality which is important to the underwriter. A risk factor will rarely produce extra mortality at a level of +100% in each successive duration group, that is, in years 1-5, 6-10, 11-15, 16-20, and so on. The extra mortality is often concentrated in the early years after issue. Thus, a risk factor might yield:

- +200% in years 1-5
- +150% in years 6-10
- +100% in years 11-16
- + 50% in years 16-20.

Alternatively, the extra mortality may increase with duration, or may exist only for a temporary period of time. It is important to be able to determine the pattern of extra mortality as accurately as possible, in order to calculate the most appropriate extra premium to cover the additional loss. Thus, extra premiums may be temporary or permanent, level or non-level, and may vary not only according to duration after issue, but also in relation to the age at issue.

After the compiling organization produces raw results, these are analyzed and in due course the portion of the results which might be of use to the industry is published. Unfortunately, in the past, a certain amount of material may have been discarded because the volume of data was too small to yield valid results or the data on a given impairment was not homogeneous enough to be meaningful. However, a new procedure has now been attempted, that of asking a number of supplementary companies to submit data on the risk factor in question, in order to increase the size of the sample to a statistically valid size.

## **G. EXAMPLES OF STUDIES**

Further in regard to sources of mortality data, the following briefly outlines some of the studies brought to the Committee's attention with respect to a number of risk factors.

### **1. Age and Sex**

The tables currently used by Canadian actuaries as standard mortality tables are the 1969-75 Tables of the Canadian Institute of Actuaries based on the experience of insured lives in Canada in those years. Separate tables have been constructed for males and females, medically examined and non-medically examined business, and give the experience of each year of issue for the first 15 years and years of issue 16 and later combined. The 1969-75 CIA Tables measure the experience of six years and involve an exposure of



nearly 40,000,000 policy years and more than 363,000 policies terminated by death.

Another study referred to by actuaries is one initiated by the Superintendent of Insurance for the State of New York. The Superintendent requested that a number of the larger companies licensed to do business in New York, who utilized a variety of marketing techniques in selling disability income insurance, submit their experience for the years 1968 to 1973 to the Department. This study determined that sex of the insured is a valid basis for classifying disability income insurance.

Statistics published by government agencies are another source of data referred to by actuaries. The table below illustrates recent data available from Statistics Canada.

TABLE 3  
STATISTICS ON LIFE EXPECTANCY—MALES AND FEMALES—CANADA  
(Based on population enumerated in 1976 census, with deaths occurring between 1975 and 1977)

Age	Females	Males	Difference
10	68.71	61.57	7.14
20	58.95	52.09	6.86
30	49.25	42.96	6.29
40	39.67	33.59	6.08
50	30.51	24.86	5.65
60	21.96	17.23	4.73
70	14.33	11.05	3.28
80	8.14	6.44	1.70
Lifespan 1976	77.48	70.19	7.29
1971	76.36	69.34	7.02

Source: Statistics Canada

## 2. Medical Impairment

A most recent and yet uncompleted study of medical impairments as risk factors is the *Medical Impairment Study* of June 15, 1978. The investigation will cover the experience of policies issued during the years 1952 to 1976 inclusive, traced from the policy anniversaries in 1962 to 1977. Extra mortality associated with over 200 impairments singly or in combination will be measured.

Twenty-eight companies have agreed to submit data, including six Canadian companies. The data submitted do not contain any information sufficient to identify the policyholder, but are a record of the major characteristics of the policyholder and the policy, such as the age, sex, height, weight, amount of insurance, date of issue, date of termination, cause of termination (whether by death or otherwise) and, of course, the record of impairments. The deadline for submission of data contributions was September 1979, but some companies have not met the deadline. The work on the compilation of results will not start for another few months.

Another set of studies brought to the Committee's attention are the Society of Actuaries Build and Blood Pressure Studies. These studies measure the experience of insured lives who are overweight or who have some elevation of their blood pressure. The latest study is described as the 1979 Study and involved the collection, processing and analysis of records on more than 4,000 insured male and female lives. This latest industry study measured the experience from 1954 to 1972. The previous study of this nature was published in 1959 and covered the years 1935 to 1954.

Also noteworthy is the book, "Medical Risks: Patterns of Mortality and Survival", by Dr. Richard B. Singer and Louis Levinson, a Fellow of the Society of Actuaries. This is a volume of reference tables of comparative mortality and survival data for a variety of impairments based mostly on studies done outside the insurance industry.

The work was started in 1968, but because the organizers were breaking new ground in a number of directions, the first volume was not published until 1976. During that time, a large number of medical directors of the various companies and a small number of actuaries were recruited to review some 2,000 articles reporting the experience of individual impairments from a variety of sources and those which contained useful data were transferred into a standardized format for use in insurance pricing.

There are four studies in this book which come from Ontario sources. One is a study of arthritis from the Queen's University Rheumatic Diseases Registry, another is a study of alcoholic patients admitted to the Toronto Clinic of the Addiction Research Foundation, a third is a study of patients with spinal cord injuries in three Toronto Hospitals, and lastly a study of ventricular septal defects from the Hospital for Sick Children.

Work is underway to produce a second volume to both update and expand the first. It is expected that this project will be continued on an ongoing basis to take into account current experience studies.

The Committee also learned that, in order to test the accuracy of past assessments of impaired risks, the Mortality Committee of the Society of Actuaries recently undertook a small study of the results of a number of major insurers. This study covered the period 1972 to 1977. Companies were asked to combine their experience into three segments:

Slightly impaired—mortality expected up to 175%

Moderately impaired—mortality expected between 176% to 250%

Severely impaired—mortality expected over 251%.

The preliminary results of the nine companies who have submitted data so far showed actual experience as follows:

Slightly impaired—153%

Moderately impaired—193%

Severely impaired—299%.

These results indicate that the classification processes in use in these companies are broadly equitable for these groups of impairments.

### **3. Other Risk Factors**

Periodic reports are prepared by the Society of Actuaries on industry experience and statistics published by government agencies on activities considered to be of a hazardous nature. For example, the 1976 Society of Actuaries' Reports provided data on exposure and deaths for both civilian and military flying in Canada and the United States and for a number of avocations including hang-gliding, motor vehicle racing, power boat racing, underwater diving and sport parachuting.

## **H. OBSERVATIONS ON RISK FACTORS AND SOURCES OF MORTALITY DATA**

Based on the preceding review of life insurance industry underwriting practices, the Committee wishes to address in this section two broad topics related to these practices:

- the statistical validity of factors used by the industry to classify risks, under the heading of the risk classification process;
- the acceptability, from a non-actuarial viewpoint, of risk classification by sex.

### **1. The Risk Classification Process**

The Committee sees that the underwriting process involves, as its most important function, the identification and evaluation of characteristics which effect longevity. Only by such identification and evaluation can the cost of life insurance be apportioned equitably based on the degree of risk which a person adds to the risk pool.

Extensive categorization of risks has been carried out over many years by the life insurance industry. However it is the Committee's view that only now, with the advent and proliferation of computer services, is the industry able to justify on the basis of sound statistical evidence that many of the risk classifications which it performs are in fact equitable. That is, the Committee believes that the life insurance industry is only now close to being able to justify or relate many of the "guesses" it took in the past with respect to risk classification. This new ability to back up the rating process with statistics is evidenced by the recent spate of statistical studies brought to the Committee's attention, particularly in regard to medical impairments.

While the Committee recognizes that the past practice of "combining art with science" in underwriting was the best approach possible to developing a risk classification system, the Committee believes that the recent trend to statistical studies of risk factors signifies that the industry is able to as-

sume a fundamental redirection in its approach to underwriting. This redirection is towards increased support of industry underwriting practices with sound statistical evidence of the relationship between risk factors and life expectancy. The Committee strongly advocates such a redirection.

7.1 The Committee recommends that the life insurance industry in its underwriting practices must start with the premise that everyone is a standard risk and must only rate a person as substandard or deny coverage on the basis of personal risk characteristics if those characteristics can be proven systematically to require that an extra premium be assessed. The Committee contends that the life insurance industry must reduce its reliance on medical judgment and on the judgment of the underwriter. These conclusions of the Committee are not intended to eliminate entirely the role of judgment in underwriting but they are intended to reduce that role as much as possible.

To ensure in this Province the greater objectivity of the underwriting process for life insurance, the Committee sets out a number of further recommendations.

7.2 The Committee recommends that all life insurance companies licensed in this Province and preferably across Canada should participate in an industry-wide program to collect and analyze mortality statistics on risk factors used in the underwriting process.

The Committee is concerned that the present system of occasional, voluntary mortality studies is inadequate. Reliance on the voluntary participation of insurers tends to slow the collection and evaluation of mortality data. The Committee is also concerned that many of the studies presently carried out by the Society of Actuaries, the Association of the Life Insurance Medical Directors of America and others depend on the cooperation of insurers both in Canada and the United States. The Committee would like to see the life insurance industry in Canada less dependent on the initiatives or cooperation of life insurance companies in the United States when it comes to such a fundamental area of life insurance operations as the collection, analyses and application of mortality data.

7.3 The Committee recommends that the Superintendent of Insurance require all life insurance companies licensed in this Province to report to him summary statistics on the numbers of policies rated and the numbers of applications denied.

The Committee recommends that the Superintendent monitor the progress of the industry in reducing the extent of substandard rating, particularly in regard to those risk factors which do not readily demonstrate a statistical relationship to mortality. Evidence provided to the Committee by the industry indicates that, in relative terms, the number of substandard or denied policies is small. Nevertheless the Committee believes that the Superintendent has a special obligation to act on behalf of those persons who *are* af-



fectured by substandard ratings as the penalty of denial of coverage or of the high cost of coverage is a harsh one in terms of its consequences on the dependants of the insurance applicant.

7.4 The Committee further recommends that the Superintendent from time to time conduct enquiries into the underwriting practices of life insurance companies and require that evidence be presented to support the use of various risk factors as underwriting criteria.

## **2. Risk Classification on the Basis of Sex**

### *The Validity of Rate Discrimination on the Basis of Sex*

Differential premium rates for males and females are long-established in the pricing structure of the life insurance industry. Statistics, from various sources, demonstrate that males as a class have a shorter life expectancy than females as a class.

The life insurance industry therefore holds that males should pay a higher premium than females for life insurance which provides death benefits. Conversely the life insurance industry holds the males should pay a lower premium than females for equivalent monthly amounts of annuity income.

In automobile insurance, the Committee questioned the validity of rate discrimination on the basis of sex. It questioned whether sex was a surrogate rather than a direct factor related to claims experience. In life insurance, the Committee recognizes, based on experience to date, that expectations of longevity differ between males and females as classes of risk. The Committee finds therefore that the differential in premium rates between males and females is actuarially sound in basis. The Committee also finds that any departure by life insurance companies from differential rates for males and females as classes of risk, other things being equal, would not be justified on actuarial grounds.

The Committee recognizes however that The Ontario Human Rights Code prohibits, in specified circumstances, discrimination on the basis of a number of factors including sex.

Because concern has recently developed in other jurisdictions about the possible applicability of human rights legislation to life insurance, the Committee has been asked to consider the recommendation of the CLIA that The Ontario Human Rights Code not apply to contracts of life insurance and annuities issued by insurance companies licensed in this Province. The CLIA states that this exemption from The Ontario Human Rights Code is sought because "the kind of differentiation involved in the life insurance risk classification system is fair as opposed to unfair differentiation, and is essential in a private, voluntary life insurance market where individuals have the freedom to choose whether or not to buy and from whom to buy. The classifica-

tion system used by life insurance companies in fact results in equality of treatment of individuals.”

Notwithstanding the above viewpoint, the Committee believes that the validity of rate discrimination on the basis of sex could be questioned on human rights and social grounds.

The process of risk classification in life insurance could be described as unfair in terms of human rights, to the extent that it results in differential treatment of persons classified on the basis of a factor that is socially unacceptable as a discriminatory factor in other than insurance fields of endeavour. Or at least it could be considered as inconsistent in its treatment of individuals in this Province. That is, risk classification by sex results in either an advantage or a disadvantage to each person buying life insurance according to the class into which he or she happens to fit. The thrust of the provisions of The Ontario Human Rights Code is that no person should be entitled to an advantage or disadvantage solely on the basis of sex in circumstances governed by the Code.

The Committee’s own concern is for the individual. This concern leads the Committee to consider whether, on social grounds, the personal attribute of sex, all other factors being equal, is an appropriate basis for treating an individual applicant for life insurance as part of a class with the average attributes of that class.

Of particular concern are situations in which treatment of individuals as a class has an adverse effect on individuals in the class. Such situations are said to arise in life insurance when men are charged higher premiums than females for the same amount of life insurance protection and when females receive less in monthly or annual life annuity payments than males for the same amount of premiums contributed. Such situations are also said to arise in life insurance when individuals who may die at the same age are charged different premiums or receive different amounts of annuity income based on the fact that they are of a different sex.

In this latter situation individuals are attributed the characteristics of the “average” person in their sex class. For example, as the “average women” dies later than the “average man”, all women are rated for life insurance in a manner different from all men, although there is considerable overlap in the distribution of the death ages of both sexes.

Such treatment of persons as a class may have an adverse effect on certain individuals whose longevity differs significantly from the class average which determines the standard rate basis for the premiums to be paid.

These concerns about risk classification on the basis of sex have been brought to the Committee by:

— The Ontario Confederation of University Faculty Associations,

- The Canadian Association of University Teachers and
- The Ontario Status of Women Council.
- The Ontario Committee on the Status of Women

The latter group has in its submission quoted a judgment of the American Supreme Court which points out that “When insurance risks are grouped, the better risks always subsidize the poorer risks. Healthy persons subsidize medical benefits for the less healthy. . . . Nothing more than custom makes one subsidy seem less fair than the other.”<sup>1</sup>

However, the Committee finds that adverse effects, to the extent that they occur in classifying life insurance applicants by sex, are not inherently unfair to the individuals involved. This results from the nature of insurance:

- That individuals participate voluntarily in a pool of risk with full knowledge that depending on the time of death they may pay more or less than others for the same amount of protection.
- That risk classification on the basis of factors directly related to longevity, as proven by statistical studies, reduces the chances of an inequitable premium burden over the whole population of individual insureds, although it may increase the premium burden for certain individuals or segments of the population beyond that justified by actual longevity experience.

*The Challenge to Rate Discrimination on the Basis of Sex under Alberta's Human Rights Legislation.*

Before outlining its own conclusions on the matter of risk classification on the basis of sex, the Committee notes that during the course of its hearings it reviewed the complaint filed by Ms. P. A. Cairns, alleging discrimination on the basis of sex contrary to the provisions of The Individual's Rights Protection Act in Alberta. The resulting report by the Board of Enquiry of The Alberta Human Rights Commission is summarized in this Report in Appendix F. The Board in Alberta ruled that there had been a breach of the Act in that a life insurance company had discriminated against the complainant because of sex by projecting a smaller amount of annuity income to the complainant than would have been the case had she been a male.

The Committee has reviewed the provisions of the Alberta Individual's Rights Protection Act relevant to the Cairns case and found that the relevant section, Section 2, reads as follows:

1. *Pension World*, Vol. 14, No. 11, November 1978, quoted by The Ontario Committee on the Status of Women, Supplement to “Towards Equity in the Pension System”, Presented to the Royal Commission on the State of Pensions in Ontario, February 1980.

“No person, directly or indirectly, alone or with another, by himself or by the interposition of another shall:

- (a) deny to any person or any class of persons any accommodation, services or facilities customarily available to the public, or
- (b) discriminate against any person or class of persons with respect to any accommodation, services or facilities customarily available to the public,

because of the race, religious beliefs, colour, sex, ancestry or place of origin of that person or class of person or of any other person or class of persons.”

The Committee further examined the provisions of The Ontario Human Rights Code to determine whether the practice of classifying individuals on the basis of their sex could be challenged under The Ontario Human Rights Code as it had been challenged under Alberta’s human rights legislation.

However, The Ontario Human Rights Code does not include a provision strictly comparable to the above mentioned provision in the Alberta Act. The only comparable provision in the Ontario legislation, Section 2, is headed and reads as follows:

*Discrimination Prohibited in places to which Public Admitted*

“2.—(1) No person, directly or indirectly, alone or with another, by himself or by the interposition of another, shall,

- (a) deny to any person or class of persons the accommodation, services or facilities *available in any place to which the public is customarily admitted*; or
- (b) discriminate against any person or class of persons with respect to the accommodation, services or facilities *available in any place to which the public is customarily admitted*.

because of the race, creed, colour, sex, marital status, nationality, ancestry or place of origin of such person or class of persons or of any other person or class of persons.”

The Committee’s understanding of the Human Rights Code in Ontario as presently written leads it to believe that a challenge to the practice of risk classification in life insurance on the basis of sex could not be brought under the Ontario Code.

*Recommendations With Respect to Risk Classification on the Basis of Sex*

7.5 After reviewing the matter of risk classification on the basis of sex, the Committee concludes that, to the extent such risk classification is actuarially sound and makes insurance a more equitable and affordable means of income protection, it cannot be described as inherently unfair.



The Committee believes generally that risk classification is a beneficial practice in that it reduces the chances of an inequitable premium burden over the whole population of insureds, that is, it reduces cross-subsidization of risks. Specifically with regard to the matter of risk classification on the basis of sex, the Committee finds that such classification is actuarially sound in basis. Accordingly the Committee recommends no change in The Insurance Act with respect to the freedom of life insurers to practise risk classification by sex.

- 7.6 On the other hand, the Committee recognizes that risk classification by sex can be questioned on social grounds as a discriminatory practice. The Committee has given extensive consideration to this perspective on the issue of risk classification by sex. The Committee has concluded that because of changing social perspectives on sex discrimination, no change should be made to The Insurance Act at this time to “protect” in the Act the present system of risk classification by sex. Accordingly, any future initiatives by insurers to remove sex as a rating criterion or any future broadening of the provisions of The Ontario Human Rights Code to include discrimination with respect to insurance matters would not require a corresponding amendment to The Insurance Act. The Committee does not however advocate any such broadening of The Ontario Human Rights Code at the present time.
- 7.7 One further matter has come to the Committee’s attention in studying the matter of risk classification. The Committee notes that Section 114 of The Insurance Act reads as follows:

“Any licensed insurer that discriminates unfairly between risks in Ontario because of the race or religion of the insured is guilty of an offence.”

The Committee recommends that this section be amended to eliminate the word “unfairly” in order to remove any doubt that discrimination can be practised if based on actuarial proof of life expectancy differences for classes of risk defined by race or religion.

- 7.8 The Committee further draws the attention of the Superintendent to the provision of The Ontario Human Rights Code which names, among other factors, race, creed, colour, nationality, ancestry or place of origin as characteristics with respect to which discrimination is prohibited. The Committee recommends that these characteristics be considered by the Superintendent for inclusion in Section 114 of The Insurance Act.

## **I. COLLECTION OF RATING INFORMATION**

In order to determine the appropriate classification for each applicant for life insurance, insurance underwriters seek information from a variety of sources. The individual sources of information are discussed below.

## *Application Forms*

Each application for insurance is accompanied by an application form signed by the applicant, who warrants that all answers are full, complete and true.

The first section of the application contains questions of a general nature—identification, other life insurance holdings, occupation, sports and aviation activities, and insurance sought.

The second section contains questions of a medical nature. This will be completed at the same time as the first section, unless a medical examination is required because of the size or type of the policy, or because of the age of the applicant. This section may or may not, depending on company policy, be filled out in the presence of the company's medical examiner. The medical information, and certain of the non-medical information, is used by the underwriters, including the medical examiner, to assess the risk involved with the applicant.

The application form also contains sections authorizing the insurer, subject to the applicant's signature, to obtain a consumer report and information from the Medical Information Bureau. The application may also contain brief descriptions of a consumer report and how it is prepared as well as a description of how information is obtained from the M.I.B.

## *Agent's Reports*

An agent normally submits his own report along with each application for insurance. While the reports vary from company to company, the information called for in the reports generally includes such things as estimates of the applicant's and the spouse's income, amounts of other insurance, and any other unfavourable health or general insurability factors known to the agent. It also requires the agent to certify that all statements and answers on the insurance application are true.

## *Medical Examiner*

Medical examiners are employed by insurance companies to assist in providing information relating to underwriting risk. Their specific responsibilities vary, depending on the size and philosophy of the particular company.

The extent of the examination and investigation of an individual applicant is largely determined by pre-set company underwriting rules. These rules provide for different investigations depending on the age of the applicant, types of coverage requested and the amount at risk.

Where necessary, the medical examiner with the consent of the applicant will communicate with the individual applicant's physician, and/or

with the Medical Information Bureau to obtain further medical information.

Once all the necessary medical information has been obtained, the medical examiner is able to assist the underwriters by assessing the risk posed by the individual applicant's health.

### *Attending Physicians*

When an application is received for a large sum of insurance, or when it appears from the application form that further medical information is required, the applicant's personal physician is consulted for clarification or confirmation of health history.

Written authorization to obtain this information is obtained from the applicant.

### *Medical Information Bureau*

The Medical Information Bureau (M.I.B.) is a non-profit association of more than 700 insurance companies operating in the United States and Canada. The Bureau acts as a central bureau for medical-actuarial statistics for mortality-morbidity related studies, and exchanges medical information on behalf of its members.

A member company may request information relating to an applicant, and any information relating to that person will be released, providing that the company has a signed application and authorization of consent from the person concerned. The Bureau does not store an applicant's complete medical record or insurance company's file. It does register name, birth date, place of birth, occupation and, in three-digit code form, any medical factors and selected other factors that could affect insurability. This record is kept for a maximum of seven years.

Membership in M.I.B. requires a company to report any significant underwriting information, favourable or unfavourable, but not the amount of insurance or decisions on a particular application.

Applicants may request information to be released to themselves and they may dispute its accuracy. The medical information will however, not be disclosed to applicants, but only to their personal physicians.

Neil Day, President of M.I.B., stated in his presentation to the Committee that "M.I.B. rules stipulate that a member company may not take any unfavourable underwriting action wholly or in part on the basis of M.I.B. information. Such information serves only as an 'alert' to the member, which must through other sources, gather additional information to substantiate an unfavourable underwriting decision".

## *Investigative Consumer Reports*

It is the practice of certain life insurance companies to use the services of an inspection company in order to obtain an independent opinion of the applicant's background, his occupation, social environment, home life and habits.

The determination of whether to secure an investigative consumer report will be made by a life insurance company on a case-by-case basis. A number of factors will be considered in making this decision such as:

- the amount of insurance applied for,
- the age of the individual,
- whether the individual is presently a policyholder of the company.

The sources of information used by the inspection firms are friends, neighbours, business associates and employers.

The information thus obtained is used as an independent check on information received in the application form, and also as a new source of information which may be useful in determining risk.

The Committee has found that personal investigation or consumer reports are requested by some companies in the following circumstances:

1. The application is for over \$75,000 or for over \$100,000 of coverage. The applicant may be exempt if a report was requested in the last 3 years.
2. The applicant is over 60 years old.
3. By age, by a sharply decreasing dollars of coverage limit which ranges from \$150,000 to zero.
4. When the internal summary underwriting rating score is over a certain limit.
5. According to the underwriter's discretion but with reference to the following factors in particular:
  - alcohol abuse
  - drug abuse
  - driving criticism
  - hazardous occupations
  - hazardous avocations
  - insurable interest

The Committee notes further that at least one company, the Mutual Life Insurance Company, has reported that it has voluntarily stopped the practice of seeking "investigation reports" from consumer reporting agencies.



## Internal Company Investigations

These investigations consist of a search for previous applications and policies, to ensure that data is not omitted on the current application form which could be of significance in determining the risk. Some insurance companies conduct further investigations from time to time, to obtain information about applicants from friends, neighbours, business associates and employers.

## J. PRIVACY AND USE OF PERSONAL INFORMATION

### 1. Public Attitudes Toward Privacy and Use of Personal Information

The life insurance industry makes extensive use of personal information in the underwriting of its products. Concern exists among the public that this information be kept confidential and not be disclosed to other persons. Concern also exists among the public that they be informed about the use that will be made of the information collected about them and that they be given the opportunity to verify information if on the basis of personal information they are denied coverage or are rated substandard.

The high importance attached to privacy and accuracy of personal information is demonstrated by the results of a survey carried out in the United States, from which selected responses are indicated in the table below.

TABLE 4  
SELECTED RESPONSES TO AN AMERICAN NATIONAL OPINION  
RESEARCH SURVEY OF ATTITUDES TOWARD PRIVACY

Questions	Public Responses			
	Very Important	Somewhat Important	Not Important At All	Not Sure
Importance of Collecting Only Essential Personal Information	84%	12%	2%	2%
Importance of Telling How Information Will be Used	88	9	2	2
Importance of Explaining in Writing Why Information is Needed	74 <sup>1</sup>	—	23 <sup>2</sup>	3
Importance of Obtaining Permission to Release Information From File	91	5	2	2
Importance of Verifying Information in Personal Record	85	10	3	2

Notes: 1. Important

2. Not Really Necessary.

Source:

"The Dimensions of Privacy". A National Opinion Research Survey of Attitudes Toward Privacy, Conducted for Sentry Insurance, November 1978 to January 1979, by Louis Harris & Associates, Inc., and Dr. Alan F. Westin, Professor, Public Law and Government, Columbia University.

Overall, the Harris survey on attitudes toward privacy found that the general public appears to be concerned about threats to personal privacy. Also, the general public ranks insurance companies high on the list of those organizations that ask far too much personal information.

## **2. The Industry Response in Canada**

In regard to the current practices of Canadian life insurance companies in the use and disclosure of personal information, it has been found by the Committee that many companies inform applicants who are declined coverage or are rated substandard about the basis on which the underwriting decision was made, the source of data and the procedures by which the applicant can verify or correct the information used. Some companies however follow this procedure only with information collected by a consumer reporting agency under the requirements of the Consumer Reporting Act, as will be described later in this Chapter. Other companies advise their agents of declines and ratings and rely on the agent to contact the applicant with an explanation of the underwriting decision. In general, at present, insurers recognize the importance of notifying applicants about denial or substandard rating of their applications. On the other hand, the practices of Canadian life insurance companies vary significantly in regard to informing consumers about the nature and source of personal information behind their decisions to decline or rate policies.

Following are examples of practices where an applicant may be informed of a rating or decline by letter from the company's underwriter or from the agent. The Committee has found from its investigations that companies send letters which include some of the following information:

1. That an agent or representative will contact the applicant.
2. That the rating or decline was based on medical evidence or a consumer report.
3. That pertinent medical evidence will be released to a personal physician.
4. That the applicant has the right to have disclosed to him all information in the files of the consumer reporting agency that conducted investigations about the applicant, with the letter stating the name and address of the consumer reporting agency.
5. That the applicant has the right to protest the information contained in a consumer report.

There do not appear to be in general use form letters for ratings and declines for other than medical causes or for causes based on consumer report information.

The insurance industry in Canada nevertheless recognizes its responsi-

bilities to safeguard the privacy of recorded information about its policyholders or prospective policyholders. The CLIA has commented on the matter of privacy in its submission to the Committee, saying:

“Life insurance companies have a legitimate need for personal information on factors that may influence mortality costs. At the same time, they recognize the confidential nature of the personal information, including health records, in their files. Many have recently reviewed their practices relating to confidentiality and privacy.

Several life insurance companies have adopted privacy codes governing the collection, maintenance, use and disclosure of personal information. Our Association is presently involved in developing a Code of Ethics designed to ensure the confidentiality of health records and to prevent the use of undesirable practices in obtaining medical information.

We believe that life insurance companies are acting in a responsible manner in the handling of personal information, and that extensive legislation is not required at this time.”

As an example of voluntary industry responses relating to confidentiality, the Prudential Insurance Company of America, and the Excelsior Life Insurance Company have recently announced new privacy of information programs, explaining to their policyholders about their companies’ information collection and disclosure practices. The Excelsior program follows guidelines set by its parent company, the Aetna Life Insurance Company, and explains how the policyholder can learn about the nature and substance of any personal information pertaining to him or her.

### **3. The Consumer Reporting Act in Ontario**

As mentioned in the section on the underwriting process, many life insurance companies use consumer investigation or reporting agencies for the collection of certain types of personal information on life insurance applicants. Many other businesses, in particular those extending credit to consumers, also use such agencies for obtaining information on customers.

To ensure that the public in Ontario can expect responsible conduct from businesses engaged in gathering, storing, assembling, or using credit and personal information, The Consumer Reporting Act has been enacted in this Province. It should be noted that this Act does not apply to life insurance companies, although they engage in collecting personal information. Nor does the Act apply to the activities of the Medical Information Bureau, which does not directly gather information, but acts as a support organization for the life insurance industry in storing information.

The Consumer Reporting Act does, however, require that life insurance companies tell an applicant for life or health insurance if they are using

investigative agencies. If premiums are to be increased on the basis of personal information about the individual's health or lifestyle obtained from an agency, the individual must be allowed to correct any errors.

Further aspects of The Consumer Reporting Act include these requirements:

- Every reporting agency is required to disclose information to individuals upon written request.
- The agency must disclose the nature and substance of all information, including the sources of information, and the names of recipients of the consumer report which contains this information.

#### **4. Regulatory Response in the United States**

Although the CLIA is engaged in developing a code of ethics designed to ensure the confidentiality of health records, details of this code have not yet been released. In order to review some of the current thinking on ways to safeguard the confidentiality of personal information collected and used by life insurance companies it is useful to look at current proposals in the United States for regulation in this field.

In the United States, the matter of privacy of information provided to life insurance companies has received considerable attention by the National Association of Insurance Commissioners and by the federal government. In December 1979, NAIC adopted a model bill, titled the NAIC Insurance Information and Privacy Protection Model Act. Aimed at all personal lines, the model bill is designed to safeguard individuals against invasion of privacy during every stage of the insurance transaction.

Its purpose is also to strike a reasonable balance between the legitimate needs of the life insurance industry for information and the public's need for fairness in insurance information practices and protection of personal privacy. The NAIC Model Privacy Act establishes standards for the collection, use and disclosure by insurance institutions, insurance agents, and insurance support organizations of personal information gathered in connection with an insurance transaction.

At the federal level, the Carter administration has proposed a fair financial information practices bill that would establish new privacy safeguards for the records of individuals held by insurance companies, consumer reporting agencies, banks and other financial institutions. Certain provisions of the proposed bill are specific to the insurance industry.

Both "privacy proposals" are broadly comparable in that they require that:

- Individuals should be told what kind of information is being collected about them, how it will be used, and to whom it will be disclosed.



- Individuals should be able to see and obtain a copy of their records and correct any errors.
- Individuals should be able to prevent improper disclosure of their records.
- Individuals should be told the basis for an adverse decision that may be passed on personal data.

No attempt has been made to compare the two proposals in any detail. However, further commentary is provided on the NAIC model.

- Insurers are required to provide written notice of their information gathering practices to all policyholders and applicants. The notice must state whether personal information is collected from people other than the insured or applicant, and the types of information sought. It must also list the types of people who may receive this information without prior authorization.
- Upon written notice, applicants may again access the information recorded about them. They are accorded the right to correct, amend, delete, or dispute that information.
- If any adverse underwriting decision is made, the company or agent involved must give the reasons for the decision, or allow the applicant to obtain these reasons upon written request.
- Insurers are limited in the type of information on which adverse underwriting decisions can be made. For example, no such decisions can be based on a previous adverse underwriting decision. Nor can a decision be based in whole or in part on personal information received from an insurance support organization whose primary source of information is insurance institutions.
- An insurer is also limited to what persons or organizations it is allowed to disclose, without the individual's authorization, any information it receives in connection with an insurance transaction.

The NAIC Model Privacy Act provides for a strong enforcement role for the insurance commissioner of each state. But it also envisions a significant role for individuals to enforce their rights under the Act: that is, to seek access to their files, to correct erroneous information in the files, and to ask for the reasons for adverse underwriting decisions.

Neither voluntary privacy codes nor the proposed privacy bills in the United States attempt to place any significant limits on the type of information which insurance companies can collect and use. These approaches basically tackle the privacy problem from the point of view of standards of disclosure, that is, informing the applicant or policyholder about the type of

information which is collected, from what sources it is collected, and for what uses.

## **5. Observations on the Collection and Confidentiality of Personal Information used for Underwriting Purposes**

In reviewing the practices of the insurance industry in collecting underwriting information on applicants and safeguarding the confidentiality of this information the Committee has come to the following conclusion. Because the life insurance industry makes extensive use of personal information in the underwriting of its products, the Committee concludes that safeguards in use of this information should be provided to the public.

### *Standards with Respect to Confidentiality and Use of Personal Information*

7.9 The Committee recommends that standards with respect to the confidentiality and use of personal information collected for underwriting purposes should be set out in regulations to The Insurance Act, with appropriate amendment to the Act to require compliance by the industry and supervision by the Superintendent.

The Committee believes that much work has already been done by the industry both in Canada and in the United States in setting out appropriate standards for safeguarding the privacy of underwriting information. This work should provide the basis for effective privacy standards binding by force of regulation on all insurers licensed in this Province.

7.10 In general terms the Committee recommends that regulations with respect to confidentiality and use of personal information provide that:

- individuals are told what kind of information is being collected about them, how it will be used and to whom it will be disclosed;
- individuals should be able to see and obtain a copy of their records and correct any errors;
- individuals should be assured that there will be no improper disclosure of their records;
- individuals should be told the basis for any adverse underwriting decision that may be based on personal data.

### *Written Notice of Reasons for Adverse Underwriting Decision*

7.11 As a specific matter related to use of personal information, the Committee recommends that every denial or adverse rating of an application for life insurance should be accompanied by a formal written notice delivered to the applicant stating the reason or reasons for the adverse underwriting decision. The Committee recommends that this requirement be incorporated into The Insurance Act as a separate duty of life insurers under Part V of the Act or as part of the regulations pre-

viously recommended in regard to standards of confidentiality and use of personal information.

In regard to this recommendation, the Committee recognizes a possible problem in that insurers and agents may tend to increase the use of the “informal application” to avoid the notification requirement and generally to avoid the processing of applications which are unlikely to result in policy issue. This practice may prove to be difficult to detect and measure and hence to enforce if its continuance were prohibited.

It is the Committee’s view that this means of doing business is not one which would be adopted by a mature industry.

7.12 The Committee expects that the life insurance industry in this Province will prove that regulations prohibiting informal applications are not required. That is the Committee expects that all life insurance companies will treat each enquiry about a life insurance plan as an application to the extent of notifying the prospective purchaser in writing of the reasons for policy denial or adverse rating.

Should the Superintendent obtain evidence of any increase in the use of informal applications by insurers to escape the obligation to notify prospective policyholders in regard to the insurer’s decision to deny an applicant coverage or rate the applicant as a substandard risk, then the Committee recommends that the Superintendent consider the statutory requirement that no insurer can refuse to state the reason for denial or substandard rating of coverage to a person who believes he has applied for coverage, even if such application is treated informally. Appropriate protection might be afforded to the insurer in certain circumstances when denial or rating of coverage may be based on reasons such as suspicion of criminal activities by the “applicant”.

### *The Medical Information Bureau*

The Committee is concerned about the confidentiality and use of personal information held by industry-support organizations, such as the Medical Information Bureau. The Committee has examined the reliance of the life insurance industry on the M.I.B. and has enquired about the operations of the M.I.B.

7.13 The Committee is generally satisfied that the standards of the M.I.B. with respect to confidentiality of the information which it collects and files are quite strict and a reasonable protection to life insurance applicants and policyholders. Of concern to a number of members on the Committee is the reliance of life insurance companies in Canada on an industry-support organization located in the United States. While the Committee would prefer to see personal information on Canadians remain with an organization indigenous to Canada, the Committee is for

the present time satisfied that the interests of Canadian and Ontario policyholders can be protected by mandatory standards of personal information use and disclosure applied to life insurance companies licensed in this Province.

- 7.14 The Committee therefore recommends that mandatory standards of personal information use and disclosure applicable to insurance companies should be formulated so as to control the privacy of information held by industry-support organizations such as M.I.B. who derive their information from the life insurance industry. The Committee recommends that an appropriate requirement in this regard could provide that each insurance company should exercise reasonable care in the selection and use of insurance support organizations, so as to assure that the practices of such organizations comply with the privacy standards set out in regulations to The Insurance Act.





## CHAPTER 8

### The Price of Life Insurance

#### A. INTRODUCTION

The amount one pays for a product is, for most products, the cost to the consumer. In buying life insurance, what one pays,—that is, the annual premium—may bear little relationship to actual cost.

This Chapter briefly, first, on the basic characteristics of participating and non-participating policies and, secondly, on the important elements of price. These discussions serve as background to the remainder of this Chapter which then examines the consumer's ability to evaluate the *relative* cost of life insurance products, by discussing cost comparison methods and recent developments in both Canada and the United States toward improved cost disclosure.

#### B. PARTICIPATING AND NON-PARTICIPATING LIFE INSURANCE

##### 1. Participating and Non-Participating Life Insurance

In setting the premium for life insurance, the actuary takes into account mortality experience, rates of interest on investment of policy funds, and various selling and administrative costs as well as profit. As the actuary must estimate future experience, his estimate may prove to be conservative once true experience is established. In this case, after all expenses have been met, it may be found that policyholders have contributed excess premiums to the insurance pool. Under a participating policy, this excess is returned to policyholders in the form of "dividend" payments.

A life insurance policy that pays dividends is called a participating policy, and one that does not pay dividends is called non-participating.

Policyholder dividends paid to participating policyholders are in fact a return or reduction of the premiums originally paid. It is important to note that dividends under a participating policy are not guaranteed, and may be increased or decreased at the discretion of the company. Most companies provide an "illustration" or estimate of future dividends as well as a premium quote.

Both stock and mutual insurance companies may issue participating and non-participating policies. The proportion of distributable surplus arising from participating business which can go to the shareholders is limited by federal law in stock companies, in order to maximize the distribution to participating policyholders. In a mutual company the whole of the surplus earnings on participating policies belongs to the participating policyholders. Part VI includes further commentary on the distribution of profits between participating and non-participating policyholders.

## History

Both participating and non-participating types of life insurance policies began to evolve at about the same time, in the very beginnings of a scientific system of life insurance, that is, with the formation of the "Old Equitable". A brief history of the concept of a policyholder dividend system follows.

"Participating life insurance as we know it today appears to have had its origin in 1762 with the formation in London of the Equitable Society for the Assurance of Life and Survivorship, also known as the Old Equitable. Some years later, the management decided that its premium rates were too high and reduced all rates by 10 percent. This reduction was made retroactive through the payment of a cash refund, which the British called a "bonus", equal to one-tenth of all the premiums previously paid on each policy. These payments, made in 1777, were in effect refunds of excess premiums paid and were the first "dividends" as we know them today, paid on life insurance policies. In 1782 the Old Equitable declared its second dividend. This time it took the form of paid-up additions to outstanding policies. Since that time, the Old Equitable has declared dividends in additional insurance rather than in cash."<sup>1</sup>

As the life insurance industry evolved further, both participating and non-participating policies were made widely available to life insurance purchasers.

### *Current Extent of Participating and Non-Participating Business*

At present, 62 percent of the total amounts of individual life insurance owned by Canadians is participating insurance and 38 percent is non-participating. In 1978, 48.5% of the amount of new personal life insurance issued in that year in Canada was participating and 51.5% was non-participating. 83% of the total whole life, 97% of the total endowment, and 26% of the total term insurance bought in 1978 was participating insurance, as derived from the table below.

TABLE 1  
INDIVIDUAL LIFE INSURANCE EFFECTED IN CANADA IN 1978<sup>1</sup>  
BY PARTICIPATING AND NON-PARTICIPATING POLICY COVERAGE  
(\$ million)

	Participating	Non-Participating	Total
Whole Life	\$ 9,145	\$ 1,895	\$11,040
Endowment	1,985	51	2,036
Term	5,727	15,931	21,658
Total	<u>\$16,857</u>	<u>\$17,877</u>	<u>\$34,734</u>

(1) For federally registered companies only.

Source: Report of the Superintendent of Insurance, Ottawa, 1978.

1. Metropolitan Life Insurance Company presentation to the Select Committee on Company Law, September 1979.

The reduction in the overall proportion of new policies, as compared to policies in force, which are participating is partly the result of the changing mix in types of policies sold towards more term insurance. As term insurance accounts for a high proportion in face amount of individual life insurance coverage bought today, and as the term insurance sold today is largely non-participating, the amounts of new personal life insurance issued have shifted to a greater proportion of non-participating insurance.

There are about twelve active federally licensed companies that sell only participating life insurance, ten of whom are United States companies. There are about 42 active federally licensed companies that sell only non-participating life insurance, 10 Canadian companies, 4 British companies and 28 foreign companies. Included are a number of reinsurance companies. Of the 42, 16 sell term insurance only and 3 sell whole life insurance only.

The following figures provide a split for all major categories of life insurance business between participating and non-participating premium income of federally chartered and provincially incorporated life insurance companies in Canada in 1978.

**TABLE 2**  
**PREMIUM INCOME: PARTICIPATING VS.**  
**NON-PARTICIPATING INSURANCE IN CANADA—1978**

	Participating		Non-Participating	Total
	(\$ million)	% of Total	(\$ million)	(\$ million)
Individual Insurance	\$1,542	77.7%	\$ 442	\$1,984
Individual Annuity	223	20.9	842	1,065
Group Insurance	390	48.4	416	806
Group Annuity	205	17.3%	983	1,188
	<u>\$2,360</u>	<u>46.8%</u>	<u>\$2,683</u>	<u>\$5,043</u>

*Note:* The "total" figures differ slightly from those in the CLIA "Facts" due to the inclusion of some out-of-Canada business of provincial companies.

*Source:* Canadian Life Insurance Association

It is interesting to note that, while participating policies account for 48.5% of the amounts of insurance sold as new policies in 1978, they account for 77.7% of premium income received. This differential results from a combination of the following:

- Of the amount of new participating insurance effected in 1978 and shown in Table 1, 66 percent was either whole life or endowment, that is, cash value insurance; 34 percent was term insurance.
- Cash value policies, accounting for two-thirds of participating insurance purchases, are on average small in amount of coverage but high in average premium relative to term policies.



- Participating premiums tend by definition to be conservatively priced and hence high in premium cost relative to the face amount of coverage.

No data are available to indicate the actual number of policies which are participating or non-participating.

It is also interesting to note that group insurance premiums were in 1978 about equally participating and non-participating, even though most group insurance is sold on a term basis. In contrast, only about 20 percent of annuity premium income, whether individual or group, was related to participating contracts.

## **2. Premium Assumptions and Premium Cost**

### *Premium Assumptions*

Participating life insurance premium assumptions, with regard to mortality, interest and expenses, are designed to be conservative. The excess premium charge based on conservative estimates is to ensure that income is adequate to cover the future expenses and obligations of the company. Once the company has established its true experience, interest and costs, a surplus is expected to arise, which is to be distributed back to the policyholders in the form of a dividend. This dividend is in fact a return or reduction of the premiums originally paid. In contrast, non-participating policy premiums are based on "most likely" estimates, are lower than participating policy premiums, and therefore do not create as large a surplus. When surplus does arise, it accrues to the insurance company.

As previously noted, participating policy dividends are not guaranteed. The distribution of dividends depends, first, on the creation of a surplus and, secondly, on the decision of the company to distribute dividends rather than retain all or some part of the surplus in a surplus fund.

### *Premium Cost Differences*

The CLIA provided in its submission the following comment on premium differences between participating and non-participating policies:

"A non-participating policy provides a lower fixed premium outlay than a participating policy. Because of the policy dividend system, however, the actual annual outlay under a participating policy, that is, the premium less dividend, should eventually be less than the annual outlay under a non-participating policy."

The extent to which dividends will reduce the cash outlay on a participating policy, possibly below that on a non-participating policy, is determined by the mortality experience, expense experience and investment income experience of each company. As the original premium assumptions for participating policies are designed to be conservative it is quite probable that a portion

of the higher premium on these policies will be returned in the form of dividends.

However, the long-term difference in value between these two types of insurance should not be great unless the mortality, expense and investment return assumptions used in pricing both types of policies are proven by experience to be much too conservative. In such a case, the cost to the consumer of a non-participating policy will not change, but the cost of a participating policy will be decreased significantly by dividend payments.

The differing assumptions used in calculating premiums and the expectation of dividends in one case and not in the other make it difficult to compare the actual costs of two policies, when one is a non-participating policy and the other is a participating policy. The greater difficulty lies in evaluating the actual cost of the participating policy, as neither the amount nor the timing of dividends is guaranteed. As this matter is of importance to the consumer who wishes to comparison shop, it will be discussed more fully later.

### *Concerns with Respect to Overcharge in Participating Premiums*

It has been stated by some industry critics that premiums paid on a participating policy include an overcharge. This overcharge provides the insurance companies with interest free money. It has also been stated that, because of this, companies actively seek participating business. For example, by paying insurance agents a commission based on premium income, they ensure that their agents will try to sell participating business, with higher premiums.

In this same context, another concern has been expressed—that the term “dividend” is misleading as it is commonly used to refer to a return on the investment of funds. It is argued that in the case of participating insurance the payment made to the policyholder is in fact a “refund” on an overcharge of premiums.

## **3. The Impact of Inflation on the Non-Participating Policy**

### *Problems in Developing a Competitive Non-Participating Product*

It is argued that the relative attractiveness of non-participating and participating insurance has been fundamentally changed by inflation.<sup>1</sup> Whereas the difference in value between these two types of insurance was not great when rates of interest and inflation were lower, it is now said that it is difficult for a non-participating company to offer a competitively valued product because of the need to be conservative in guaranteeing a rate of return for up to 30 or 40 years into the future.

1. The Federal Trade Commission, Staff Report, “Life Insurance Cost Disclosure”, June 1979, pg. 40.

Mr. E. J. Moohead, retired actuary and a recognized commentator on the life insurance industry in the United States, points out the problem in attempting to develop a competitive non-participating product:

“Actuaries attempting to calculate nonpar premiums that will be competitive with illustrated prices of participating policies are faced with a problem that has no satisfactory solution. The actuary, concerned as he must be with company solvency and prosperity, dares not assume in his calculations that high investment yields will continue for many future years even though he usually is personally convinced that continuing inflation will produce that result. Hence, he calculates nonpar premiums by allowing for high interest rates in the early years (when it really makes little difference what interest rate he assumes); and he grades the assumed interest rate downward in later policy years (when the policy reserve will have reached a size that makes even small interest rate differences of material consequence). In the past several years during which this observer has been publicly pointing this out, no actuary experienced in nonpar premium calculation has risen to dispute its validity.”<sup>1</sup>

The problems pointed out by Mr. Moorhead are most applicable in whole life and endowment policies, because of the long-term nature of such policies.

The life insurance industry, in the submissions of various persons, companies and organizations to the Committee, has acknowledged that consumers who purchased non-participating whole life policies in the 1940's, 1950's and 1960's were hard hit by inflation. On the page facing is an example provided to the Committee by the London Life Insurance Company of a \$10,000 policy issued to a male age 25 in 1940 whose actual history is carried through to the 1980 anniversary, the last anniversary for which a dividend scale has been set. The results of this example, and similar examples for 1930, 1950, 1960 and 1970 issue dates, demonstrate the long-term cost advantages that have accrued in the past to the participating policyholder.

### *Alleviating the Problems Faced by the Holder of an Older Non-Participating Policy*

Recognizing that the holders of old non-participating policies are locked into a premium structure that forces them to pay considerably more for their coverage than is being paid by new policyholders and by participating policyholders, a number of insurance companies have allowed certain of their non-par policyholders to convert their policies into par policies. The extent of this practice is unknown.

1. E. J. Moorhead, “Doomsday Just Ahead for Life Insurance? Not Necessarily!” *Best's Review*, August 1977.

TABLE 3

ILLUSTRATION OF THE PREMIUM LESS DIVIDEND DIFFERENCES  
BETWEEN A PARTICIPATING AND A NON-PARTICIPATING POLICY

1940 Issue:	Whole Life	Age 25	\$10,000		
	Par	\$165.00			
	Non-Par	\$135.10	Initial Par Excess <sup>(1)</sup>	\$29.90	
<u>Year</u>	<u>Dividend</u>	<u>Net Par Excess (Less Dividend)</u>	<u>Accumulated Net Par Excess</u>	<u>Assumed Interest Rate for Accumulation</u>	<sup>(2)</sup>
1940	-	29.90	29.90		
1941	29.50	.40	31.20	3	
1942	30.30	-.40	31.74	3	
1943	26.10	3.80	36.49	3	
1944	26.90	3.00	40.58	3	
1945	27.70	2.20	44.00	3	
1946	28.60	1.30	46.62	3	
1947	34.70	-4.80	43.22	3	
1948	35.50	-5.60	38.92	3	
1949	32.50	-2.60	37.49	3	
1950	34.10	-4.20	34.41	3	
1951	35.70	-5.80	29.99	4	
1952	42.10	-12.20	18.99	4	
1953	44.20	-14.30	5.45	4	
1954	46.20	-16.30	-10.63	4	
1955	53.90	-24.00	-35.06	4	
1956	56.30	-26.40	-62.86	4	
1957	67.60	-37.70	-103.07	4	
1958	70.30	-40.40	-147.59	4	
1959	77.60	-47.70	-201.19	4	
1960	80.70	-50.80	-260.04	4	
1961	90.60	-60.70	-336.34	6	
1962	94.20	-64.30	-420.82	6	
1963	105.20	-75.30	-521.37	6	
1964	112.30	-82.40	-635.05	6	
1965	116.70	-86.80	-759.95	6	
1966	124.50	-94.60	-900.15	6	
1967	128.70	-98.80	-1,052.96	6	
1968	137.80	-107.90	-1,224.04	6	
1969	142.40	-112.50	-1,409.98	6	
1970	147.10	-117.20	-1,611.78	6	
1971	151.90	-122.00	-1,862.72	8	
1972	156.80	-126.90	-2,138.64	8	
1973	161.80	-131.90	-2,441.63	8	
1974	169.20	-139.30	-2,776.26	8	
1975	187.30	-157.40	-3,155.76	8	
1976	192.50	-162.60	-3,570.82	8	
1977	223.40	-193.50	-4,049.99	8	
1978	240.30	-210.40	-4,584.39	8	
1979	293.80	-263.90	-5,215.04	8	
1980	376.30	-346.40	-5,978.64	8	

Source: The London Life Insurance Company

- (1) Par Excess - difference between par premium and non-par premium, assuming that dividends payable are used to reduce the annual participating premium.
- (2) The interest rate chosen is an arbitrary rate for each decade roughly representative of what a small saver could obtain for small amounts.



Alternatively, in cases where companies have not provided relief to existing non-participating policyholders, policyholders have been advised by some to surrender their old non-participating whole life policies and purchase new participating whole life policies or purchase term insurance.

Other measures have also been suggested to alleviate the problems faced by the older existing non-participating policyholders. It has been suggested, for example, that companies unilaterally either reduce the premiums on these policies or increase cash values or death benefits.

### *The Future of Non-Participating Products*

As to the future, uncertainty and expectations of continuing inflation complicate the ability of actuaries to make reasonable “most likely” estimates over a long term in the calculation of non-participating policy premiums. Suggestions have therefore been put forward with respect to two alternatives to the traditional non-participating whole life policy.

First, it has been suggested that life insurers be exhorted to initiate new products that are better suited to cope with inflation. “New money”, adjustable benefit policies, already introduced in this Province and described in Chapter 4, are one example of such innovation. Indeterminate premium policies are another—these policies being adjustable in premium rather than in the benefits payable, adjustments being made at pre-stated periods of time in the future. Other suggestions include the combination of term insurance with a flexible premium deferred annuity in a single policy that is similar to participating cash value insurance. In the combination policy, company experience would be reflected in the portion of the fixed level premium which would be allocated to the annuity rather than towards life insurance protection.

These approaches, while helping to resolve the problems of inflation, all add complexity to the purchase of life insurance, by making benefits variable or by combining two policies in one. They tend to add to the confusion of the consumer in understanding what he is buying and in comparing policies based on benefits and cost.

As a second alternative to coping with uncertainty about future investment policies, it has been suggested that all policies be made participating policies. Were all policies, including cash value and term policies, to be made participating, competition could be expected to keep premiums low. It would seem likely that life insurers would compete first on the basis of low fixed premiums and only secondly on the basis of promises for high future dividends. As a result, it would seem reasonable to expect that the premiums on participating policies would tend toward the lower level of premiums now charged for non-participating policies. In other words, the premium assumptions used in calculating par premiums could be expected to approach the “most likely” estimate assumptions of non-par premiums.

Even so, it may be argued that those persons currently buying short-term non-par policies, such as non-par term policies, at a lower premium cost than equivalent par policies will be forced to pay more if all policies were to become participating. Insurers could, however, price all products as participating policies but without, in some cases, an illustration or promise of dividends, at least in the short term. Dividend regulations could, however, be needed to assure policyholders that excess surplus would be paid even over the short term, if earned.

The Committee notes in regard to the statements above that the CLIA in a memorandum to the Committee has given examples of innovative approaches to life insurance product design, including that of "participating policies with dividends calculated so as to lower the initial premium level below comparable non-par premium".<sup>1</sup>

The discussion now turns primarily to the participating business of life insurers and a look at dividend distribution and dividend options.

#### **4. The Participating Policy**

The participating policy, by its nature, warrants scrutiny by both consumers and regulators in regard to:

- the distribution of dividends versus retention of surplus funds;
- timing and other considerations in the payment of dividends;
- the illustration of dividends so as not to be misleading; and
- dividend options.

These matters are considered here in turn.

##### *The Distribution Versus Retention of Dividends*

Life insurance companies are able to retain any surplus arising in the participating policyholders' fund rather than distribute this surplus as it arises.

It has been suggested that there may be a need to legislate the distribution of dividends by means of limiting the amount of surplus to be retained in participating policy funds. Part VI of this Report deals more fully with the decision to retain or distribute participating policy profits.

##### *Timing and Other Considerations in the Payment of Dividends*

The availability of a dividend complicates the purchase of participating insurance. Consideration must be given not only to the amount of dividend expected to be received but also to the timing or pattern of dividend payments in determining the cost of a participating policy. Different return pat-

1. CLIA, Memorandum to Select Committee on Company Law, Re: Presentation by the U.S. Federal Trade Commission and Others, February 8, 1980.

terns are used by life insurance companies for dividends—some return dividends evenly, some increase the return towards the end of the contract, some provide dividends only when the benefits under the policy accrue.

Taking into account these factors, it is argued that the timing or pattern of dividend illustrations is vulnerable to manipulation by insurance companies. That is, insurers can set dividend policies which result in a favourable cost comparison with other policies, at commonly compared policy anniversary dates.

Another matter related to dividend return patterns is the following. A major trend in dividend philosophies has recently developed in the United States toward the use of “investment year” methods to allocate dividends to particular classes of policyholder. Under this method, dividends for new policyholders are calculated using investment yields currently attainable, rather than the overall rate on the company’s total assets. This has the effect of favouring newer policyholders at the expense of the old. In the past, dividend allocation was approached primarily on the “portfolio method”, wherein all policyholders were treated alike in computing dividends. The use of such different dividend calculation methods in the insurance industry makes dividend illustrations much less comparable between companies. This in turn distorts cost comparisons between companies.

### *Illustration of Dividends*

In regard to the amount of expected dividend, it is necessary that the consumer note that the actual dividend return can vary to a large extent from the advertised or illustrated figures, which are not a guaranteed return. As a result, the consumer interested in the actual net payments made on his participating policy would be wise to examine over the lifetime of his policy the actual dividend payments made and any company adjustments in the scale of future dividend payments.

The Consumers’ Association of Canada has recommended that a policy summary be provided to all prospective insurance buyers. In regard to illustration of dividends in the policy summary, the Consumers’ Association of Canada recommends to the Committee:

“If the policy sold is a participating policy, and if the salesperson has demonstrated projections of dividends in the sales presentation, these projections should be required to be written in by the salesperson. The statement should also be clearly made that the dividends are hypothetical, or projections only, and are not guaranteed.”

Most companies are reported already to follow this recommendation voluntarily.

### *Dividend Options*

Canadian companies declare a dividend on their participating policies



as a cash allotment, generally once a year. Dividend scales are normally held constant, and are revised only when there is a significant change in one or more of the basic experience factors.

The policyholder, in most cases, is provided with four options for dividend use:

- take the dividends in cash;
- have them deducted from next year's premium;
- leave them with the company to accumulate interest, sometimes in a segregated fund;
- apply them to the purchase of more insurance.

Another, less common option, is the application of dividends to reduce policy loans.

Under the fourth option, accumulated dividends can be used to pay up a policy. When the cash value of accumulated dividends plus the surrender value equal the face value of the policy, a straight life policy can be matured as an endowment for the face value. In addition to this "endowment option", other methods of paying premiums or buying additional amounts of paid-up insurance with the help of dividends are available. These vary from company to company.

One of these options for purchase of more insurance is now commonly referred to as the fifth dividend option and is sometimes made available with whole life policies only: it lets the policyholder buy additional one-year term insurance with the dividends.

"The recent trend among Canadian policyholders is strongly toward using policy dividends to buy more insurance or annuity income. In 1978, 39 per cent of dividends were left on deposit, 25 per cent were taken in cash, and 36 per cent were used to purchase additional amounts of life insurance or annuity income. By comparison, in 1970 the respective figures were 49 per cent, 30 per cent and 21 per cent."<sup>1</sup> The use of dividends to buy more insurance may be reflective of policyholder concern over the eroding value of life insurance policies due to the effects of inflation.

### *Considerations in Regard to Dividend Options*

Consideration must be given by consumers to any limitations which may be applied in respect to any of the dividend options. One example is the possibility that deductions from premiums may not be available unless premiums are paid annually. Consideration should as well be given by consumers to the rate of interest guaranteed on accumulated dividends and this rate could be compared to rates available from other investments.

In respect of the fifth option, it should be noted by the consumer that

1. Canadian Life Insurance Association, "Canadian Life Insurance Facts", 1979 edition.



the amount of term protection to be bought with dividends is commonly limited to an amount of protection not exceeding the cash values of the whole life policy. Any portion of the dividend remaining may be left to earn interest and help offset the increasing cost of this term coverage in later years.

With many policies, the consumer should understand that dividends cannot be accumulated or reserved for purchase of term coverages at a later date, without evidence of insurability. The fifth option in these policies can be exercised without medical evidence only if it is chosen when the policy is issued, and continued each year when each dividend is paid.

It is apparent from the preceding review that the choice of dividend options should be reviewed periodically by consumers to ensure that their dividend dollars are being used to best advantage. Policies which limit the options to the one option chosen at the time of policy issue restrict the consumer in adjusting the use of dividends to suit changing circumstances.

## **5. Observations and Recommendations on Participating and Non-Participating Policies**

In reviewing the pricing of life insurance policies, with respect to non-participating insurance, participating insurance and the payout of dividends, the Committee has reached a number of conclusions which are listed below.

### *Conversion to Participating Policies or to Non-Participating Policies*

The Committee is concerned about policyholders who years ago based on their circumstances at the time decided to buy non-participating insurance policies only to find that in the long-term, in the face of significant inflation, their choice of policy proved to be costly relative to their future needs for insurance and relative to the cost of participating insurance. Likewise, the Committee is concerned about those policyholders who find that they would prefer to buy possibly lower cost non-participating insurance rather than the participating policy they originally bought.

8.1 The Committee believes that it is in the general self-interest of insurers who wish to conserve their older, existing permanent policies to offer their long-term non-participating policyholders the option of converting their policies to participating policies, if they should wish to do so. Some companies have already provided this option. The Committee urges all companies to follow this lead and to look at ways of permitting conversion of non-participating policies to participating policies.

Likewise the Committee urges life insurers to permit conversion of participating policies to non-participating policies for those consumers wishing to make such a change during the lifetime of their policies.

8.2 The Committee is concerned however that the ability to convert policies

to either non-participating or participating policies may, in some cases, be offered only upon the request of the policyholder. As a result, many policyholders may not be aware of their company's practice to allow conversion.

The Committee therefore recommends that life insurers notify each policyholder at the next policy anniversary and at appropriate intervals thereafter about the extension of these privileges to convert to participating or non-participating policies, whichever be the appropriate case. Such notices should however point out that the dividends paid on participating insurance are not guaranteed as they are dependent on future levels of interest rates, mortality experience and expenses.

### *Dealing With the Problems of Inflation*

In general, the Committee is concerned about the difficulty that arises in setting premiums for non-participating policies in an inflationary and uncertain investment environment. Two suggestions for product change have been outlined in this Chapter as means of dealing with the problem of inflation: the first was increased product innovation and the second was the requirement that all policies be participating.

In regard to the first suggestion, the Committee welcomes and encourages the industry's initiative in developing new products that are better suited to cope with inflation. However, the Committee expects that the industry will also provide policyholders with meaningful financial information corresponding to the greater intricacies of these products. The Superintendent is urged to oversee the adequacy of financial information provided by companies to the public on their new products developed to cope with inflation.

In regard to the second suggestion that all policies be participating, the Committee does not advocate abolishing the non-participating insurance policy, but it does believe that price competition among participating policies is essential to bring premiums closer to the levels charged for non-participating insurance. In this way, the attractiveness of participating insurance would be enhanced, encouraging its purchase by consumers. This need for price competition in both par and non-par policies leads the Committee to conclude that price comparison must play an important role in the marketing of life insurance.

### *Comparing The Cost of Par and Non-Par Policies*

8.3 The difference in the relative premium costs of participating and non-participating insurance is a matter which the Committee believes is most important to a person who has limited resources for purchase of insurance. The difference should be expressly pointed out to prospective purchasers of life insurance, preferably in mandatory disclosure

material provided to the consumer at the time of sale. The prospective purchaser should be alerted to ask his agent how much insurance can be bought for a given premium if the policy is participating and alternatively if it is non-participating.

### *Illustration and Payout of Dividends*

8.4 The Committee recommends, as essential, a number of practices which should be strictly adhered to by life insurance companies in regard to the illustration and payout of dividends:

- The hypothetical nature of dividend illustrations should be clearly and effectively identified to life insurance purchasers to guard against misunderstandings by consumers.
- Policyholders should be given maximum flexibility in the use of their dividend funds, particularly with respect to the opportunity to fund additional insurance to prevent the eroding value of insurance coverage. This flexibility should not only be in the form of a range of dividend options but should also permit policyholders to switch their choice of dividend options over the lifetime of their policy.
- Insurers should undertake to inform consumers on a periodic and on-going basis of available dividend options to assist consumers in correct selection and revision of options to meet their changing needs.
- Insurers should undertake to adhere to a “portfolio method” of dividend distribution, wherein all policyholders, other than those buying variable contracts with segregated investment funds, are treated alike in computing dividends. Because insurers act as trustees for the funds of their policyholders and not as intermediaries for investment of policyholder funds, the responsibility of insurers should be to treat all policyholders equally and equitably in the distribution of dividends. That is, dividends for all policyholders should be calculated using the overall rate of investment yield on the company’s total assets.

## **C. ELEMENTS IN PRICE**

### **1. Elements in Price**

“The annual premium, of course, is the obvious element in the price structure (of life insurance). But someone who considers the annual premium alone may buy a policy that appears cheap but is in fact comparatively expensive in the long run. To see why, you must consider the other three elements in the price structure—dividends, cash value, and time.”<sup>1</sup>

The three elements in price in addition to the annual premium are considered below.

1. *The Consumers Union Report on Life Insurance*, Consumers Union of United States, Inc., 1977.



## 2. Dividends and the Net Payment

Dividends are a return of money to policyholders who have bought participating life insurance policies. The sum of the premiums paid minus any dividends received determines the “net payment” cost of insurance. The net payment cost to the policyholder is his cost of insurance if he keeps his policy until he dies.

As no policyholder knows his date of death the actual net payment cost of his insurance coverage cannot be determined at the time of purchase. The policyholder may however wish to determine the net payment cost over some specified period of time, say 5 years or 20 years, after policy issue.

The net payment cost over the specified time period is dependent on the amount and timing of dividend payments. Each company sets its own dividend distribution policies so that dividend payments can vary from year to year. For example, the pattern of distribution can determine a high net payment cost for one participating policy in early years and a more favourable lower net payment cost for the same policy in later years. That is, some insurance companies may distribute dividends to policyholders later in the life of a policy. In such a case, policyholders who terminate their policies earlier or die early may not receive the benefits of an increasing dividend structure.

Furthermore, dividends are not guaranteed and can exceed or fall below advertised levels. This adds uncertainty to the net payment measure of cost. It is also conceivable that the distribution of dividend payments could be manipulated to produce favourable net payment results at certain policy anniversary dates.

## 3. Cash Values and the Net Cost

A person buying a life insurance policy with a cash value benefit may wish to surrender his policy at some time in the future and obtain its cash value. He is likely to look for some measure of the cost of his policy relative to the amount in cash value which he receives upon surrender.

Consider two whole life policies which provide an identical amount of coverage say \$10,000; the sum and timing of premiums over time is identical and so is the sum and timing of dividends. That is the net payment cost for these two \$10,000 policies is the same.<sup>1</sup> However, in looking at the cash values of the two policies, one has a high cash value at the end of 20 years and the other has a lower cash value. In terms of the cash value accumulated after 20 years, the cost of these policies is not identical. The policy with the lower cash value upon surrender, costs more because less cash value is

1. The interest-adjusted net payment cost would also be the same. This cost measure is described on page 26.



available for a given net payment. Accordingly the net payment cost is an inadequate and only partial measure of the real cost of a cash value policy in the event the policyholder should ever choose to surrender his policy.

If the policyholder surrenders his policy, the cost of that policy to him can be roughly expressed as the sum of the premiums paid, minus dividends, if any, and minus the cash value received upon surrender. The final figure is the *net cost*<sup>1</sup> of the policy.

Note that the net cost and the net payment cost are the same for a term policy. Note also that the net cost on a whole life policy cannot be compared meaningfully with the net or net payment cost on a term policy.

As with the net payment cost, the net cost is dependent on timing, both in dividend payments and in the rate of build up of cash values. Unlike dividends, cash values are guaranteed in most policies sold by companies doing business in Canada, so that timing of cash value additions is known with some certainty prior to purchase of a cash value policy. However, cash value additions, even if guaranteed, may vary from year to year, on an irregular basis, among policies. Since in some policies the cash value build up may have been comparatively rapid while in others it may build up sharply only in later years, it is conceivable that insurance companies could manipulate their "guarantees" of cash value to produce a favourable net cost result at certain policy anniversary dates or to make a policy look good only in long-term comparisons.

The net cost measure of insurance price is known as the "traditional" method of price measurement. Dividing the net cost by the number of years in the period to be evaluated gives the average net cost per year or the net cost index.

Use of either the net cost measure or the net cost index is most meaningful only in a so-called "yardstick" comparison against several other policies. The numbers themselves have no intrinsic connotation of value to the prospective buyer as they do not represent a cash outlay by the buyer.

It is important to note that major criticisms have been levelled against the traditional method of cost comparison, including:

- its assumption that the current dividend scale will remain unchanged;
- its assumption that future dividend scales will affect companies in roughly the same manner or degree;
- its principal failure, by ignoring interest, to give any recognition to the time when a dollar is paid either to or by the policyholder.

1. Sometimes known as the surrender cost. However, the term "surrender cost" is used to describe another cost measure to be explained later in this section.

#### 4. Timing and the Interest-Adjusted Net Cost

The Consumers Union in the United States comments thus on the importance of time in the calculation of life insurance costs:

“Consider the example of two policies that appear on the surface to be identical in cost. The sum of the premiums over, say, twenty years is the same for both. So is the sum of the dividends. The cash value tables are identical. It is nevertheless possible that one of the two policies is a distinctly better buy. Suppose one of the policies has a lower premium in the early years of the contract. Even though the sum of all the premiums is the same, that policy is a better buy. By the same token, suppose one of the policies has more generous dividends in the early years; again, that policy is a better buy, other things being equal. The reason is the same in both cases: time. People can earn interest on money while it is in their possession.”<sup>1</sup>

In recent years a cost computation method has been introduced that does consider the time element. It is called the *interest-adjusted method*. The calculation of cost under this method requires that a specific interest rate be assumed, this rate being a reasonable estimate of long-term after-tax returns on savings accounts. The interest-adjusted net cost of a cash value policy over a stated period of time is derived as the sum of premiums accumulated with interest, minus any dividends accumulated with interest, minus the cash value if any at the end of the period. Similarly the interest-adjusted net or net payment cost of a term policy over a stated period of time is derived as the sum of premiums accumulated with interest minus any dividends accumulated with interest.

The interest-adjusted net cost is not a “true” cost but it represents a more realistic cost than that provided by the traditional net cost method. The interest-adjusted net cost is not a “true” cost because it is dependent on three variable elements:

- an assumed rate of interest;
- dividends, which are not guaranteed and can vary irregularly from year to year;
- cash values, if any, which are guaranteed but are not constant in amount among companies on a year to year basis.

Because the latter two elements are variable, the interest-adjusted net cost is equally as vulnerable to the potential for manipulation of dividend and cash value payments as are the ordinary net payment and net cost measures.

An average figure is often calculated for the dividend and cash value

1. *The Consumers Union Report on Life Insurance*, Consumers Union of United States, Inc., 1977.

factors, including the adjustment for interest, to provide an interest-adjusted cost over a period of time rather than *at the end* of a period, such as 20 years. The averages are identified as the “equivalent level annual dividend” and the “equivalent level annual increase in cash value.” The averaging procedure produces an *interest-adjusted net cost index*. This is an artificial number bearing no relation to any particular cash outlay made by the policyholder. But it is a useful indicator of how much a life insurance policy costs *when compared to other similar policies*.

It is noteworthy that the interest-adjusted net cost index is widely recognized as a reasonably accurate means of cost comparison given that it is useful only in comparing:

- similar policies (whole life with whole life, term with term); and
- relatively simple policies,—it cannot be used for certain complicated policies nor is it useful in comparing new money, adjustable benefit policies.

In regard to the first point, the interest-adjusted net cost index cannot be used to compare cash value policies with term policies because it provides a comparison of policies as if the policyholder were to surrender them. It therefore requires consideration of the terminal cash value, a factor which distorts comparison with term policies.

An *interest-adjusted net payment index* could be used to evaluate the cost of the policy if the policyholder were to die. The interest-adjusted net payment index is appropriate for comparing two term policies, where there is no consideration of cash values upon surrender, but would be inappropriate for a *complete* comparison of two whole life policies.

## 5. Summary

It is evident from the foregoing that the determination of the cost of a life insurance policy to the policyholder is not a simple, straightforward matter. Moreover, the methods of cost calculation described above represent only the more widely recognized and among the simplest of known methods. They represent as well only methods by which the cost of similar policies can be compared. Comparison of dissimilar policies, when required, is much more complex. A fuller discussion of developments in cost comparison methods follows.

## D. COST COMPARISON

“No one wants to choose an insurance policy by guesswork, by reacting to ads, or by succumbing to the most persistent and persuasive sales agent. Yet, in the absence of a usable tool for comparing the real prices of life insurance policies, this is just what countless consumers have done.”<sup>1</sup>

1. *The Consumers Union Report on Life Insurance*, Consumers Union of United States, Inc., 1977.



The inherent complexity of life insurance makes it much more difficult than in other insurance fields to get meaningful price information. This was made evident in the discussion earlier in this chapter concerning the elements of price. Yet in view of the fact that life insurance is an important option within a larger financial protection system, the ability to evaluate the quality and cost of life insurance costs seems especially necessary for consumers, both in evaluating:

- one life insurance policy compared to another, where the policies are similar, and
- one life insurance policy compared to another dissimilar policy and to various forms of savings as alternative methods of income protection.

It has been drawn to the Committee's attention that the absence of usable price information results in a lack of price competition, even among similar products. To the extent that consumers do not know how to determine the real cost of insurance they are not likely to compare costs of different policies among various insurance companies, except on the most elementary level of premiums as a measure of cost. In addition, a lack of cost information might channel competition away from prices to non-price competition. As a result, at least some sellers will be able to charge higher than competitive prices because few sales will be lost if real costs are increased.

Secondly, the absence of meaningful price information is said to reduce the ability of consumers to compare different types of policies, such as whole life insurance with term insurance. As a result some sellers may be able to sell certain types of policies based solely on such purchase factors as premium cost differences or "emotional" considerations rather than on any understanding by the consumer of the important cost relationships relevant to the two product types being offered.

The absence of price information is also said to reduce competition with alternative financial protection vehicles. Because consumers are not able to understand insurance costs, it is possible for insurance companies to offer lower rates of return on their cash value policies than are available from savings with other financial institutions and still compete effectively for savings dollars.

While the Committee has not engaged in any comprehensive study of competition in the life insurance market in Ontario, it is evident that lack of meaningful price information presents at the least an obstacle to competition and an obstacle to proper product choice by consumers. It appears unrealistic to the Committee to allow consumers to purchase a product as important as life insurance without some means of defining the cost of that product and comparing the cost among competing products. In fact, such a situation with respect to insurance products, to the extent that it occurs, appears to be a strange anomaly in an otherwise price conscious society.



## E. EXTENT OF PRICE COMPARISON IN ONTARIO

Until the early 1970's there appeared to be little comparative cost information available to buyers of life insurance policies in Ontario. Following is a description of recent efforts made to provide Ontario consumers with life insurance cost data.

### *Cost Information Provided by Life Insurance Companies*

It was agreed by member companies of the CLIA, early in the 1970's, that a method of cost comparison be adopted in the CLIA Guidelines for use by all member companies,

“In view of evidence of a growing desire among segments of the Canadian public for some generally acceptable method of comparing the cost of similar life insurance policies issued by different companies.”

Conflicting views led to a lack of complete unanimity on any one method as being superior to all others for cost comparison purposes. However, in September 1973 the CLIA issued the following recommendations:

“That member companies make cost indices available on request to any prospective purchaser for permanent insurance and the cost indices should include the interest-adjusted cost index calculated at a rate of interest of five percent and with values based on 10-year and 20-year durations;

That member companies phase out the use of the traditional “net cost” method of comparison.”

In 1977, the rate of interest to be used in the calculation of the interest-adjusted cost index was increased to six percent. Some of the considerations and standards concerning the above recommendations are set out in Appendix G, as set out in a supplementary CLIA memorandum. It is noteworthy that the CLIA memorandum states:

“Warnings concerning the limitations of the interest-adjusted cost index should invariably accompany it”,

and provides material adaptable to this purpose.

While endorsing the interest-adjusted net cost method, the CLIA cost comparison recommendations stop in regard to providing the policyholder with a reference or “yardstick” against which to compare the interest-adjusted index of any one company on any one policy against similar policies of other companies. Nor has the CLIA as an industry association compiled and issued a “yardstick” in the past.

The Committee notes that the index need be provided only upon request, and not necessarily in all cases. The Committee also wonders whether there is sufficient awareness on the part of the public in this Province that

comparison of similar policies requires that an interest-adjusted method be used. Notwithstanding the CLIA recommendations for use of the interest-adjusted net cost index and the practice of some insurers to include this index in their rate books the fact that this measure of cost need only be provided upon request may have limited its use by the public and even by some agents.

In addition to the cost comparison recommendations of the CLIA, member companies are recommended to provide certain cost-related information at the point-of-sale. Particular information items include:

- the amount of each of the basic and supplementary benefits and riders;
- the period over which coverage is provided;
- the premium charges in total and for the basic policy and each rider and supplementary benefits separately; and
- the periods over which the premiums for the basic and supplementary benefits and each of the riders are payable.

No specific recommendation is made for illustration of cash values or accumulating dividends. The CLIA has however brought forth recommendations respecting cost illustrations, in the case that they are provided. While there is no recommendation that they be provided, it is recognized that most companies provide "ledger sheet" information in sales promotion material, proposal forms and similar documents, as well as in the policy. The recommendations respecting cost illustrations are as follows:

1. That any illustration for a life insurance policy which aggregates premiums and benefits, whether for the purpose of comparing premiums with the benefits that flow therefrom or for the purpose of comparing an index for one policy with an index for another policy, recognize the time value of money through the use of an appropriate interest factor in the aggregation; and that the interest rate used for the purpose of determining an index for comparing two or more policies be as specified in the Association's standing recommendation on cost indices, currently 6%, and that the interest used for other purposes be either the rate used in calculating indices or such higher rate as may be justified in the circumstances.
2. That member companies and their field forces include in any illustrations summarizing cost and benefits which include cash values, the clear identification of the first year in which a cash value occurs and the amount of the cash value at the end of that year.
3. That member companies ensure that their field forces receive adequate training and sample proposal material to enable them to account for the interest factor in any cost illustration.
4. That member companies ensure that their field force uses an appropriate disclaimer with any illustration of non-guaranteed benefits.

5. That member companies take reasonable steps to review any material used by their field forces which makes reference to “investment yield” or “rate or return”. For instance, in the case of a single premium life annuity the annual payment should not be described as the “investment yield”.
6. That member companies communicate the regulations and guidelines dealing with the illustration of segregated fund growth rates to their field force and ensure compliance therewith.”

Furthermore, the CLIA guidelines state that if such illustrations are provided,<sup>1</sup> then particular reference should be made to the likelihood of a decrease as well as an increase for non-guaranteed cash value benefits and for dividends. Refer to Appendix H for the CLIA guidelines on illustrations of non-guaranteed benefits.

It is evident that the CLIA and its member companies have recognized the need to provide cost information which is more meaningful than the mere statement of annual premiums. Yet several inadequacies can be identified in the CLIA guidelines, in regard to the following matters:

- there has to date been no “yardstick” information available to consumers from the insurance industry for evaluating the relative cost of policies in terms of the interest-adjusted net cost index;
- the CLIA guidelines call for use of the interest-adjusted net cost index and therefore provide only for comparison of similar policies; the CLIA does not at the present time suggest a method of comparing dissimilar policies;
- there is no specific requirement that a “cost illustration” be provided by all companies nor is there any suggested standard for uniformity in the format or content of “cost illustrations”, with the exception of certain prohibitions.

### *A Shoppers’ Guide to Canadian Life Insurance Prices*

A further significant effort to provide information for cost comparison has been made by Mr. William McLeod, with the sponsorship of the Consumers’ Association of Canada (CAC). Mr. McLeod served as the editor of the CAC Shoppers’ Guide to Canadian Life Insurance Prices, which provides data compiled with the assistance of the Canadian Life Insurance Association. The method used in the Guide for measuring the cost of a life insurance policy is the interest-adjusted net cost method. Various whole life and term policies written in Canada are included for males and females, ages 25, 35, 45 and 55. Whole life policies, in \$10,000 and \$50,000 amounts, both participating and non-participating are included as well as yearly re-

1. The Insurance Act states only that cash value options if there are any be set out in the policy. The Act does not specify how these options should be disclosed.

newable term, five year renewable term and uniformly reducing term in amounts of \$25,000 and \$100,000.

The Committee has learned that the CAC has withdrawn sponsorship of Mr. McLeod for future publications of the Shoppers' Guide but is looking for another researcher-editor who would produce the guide on behalf of the CAC.

In the meantime the CLIA has announced that it is providing a one year subsidy to Stone and Cox Limited, a Toronto insurance publisher, to support the initial compilation of a shoppers' guide type publication, with premium rates to be supplied through cooperation of the CLIA and its members. The CLIA has said that it regards this pricing guide as a key consumer initiative.

The Shoppers' Guide is however said to be only a step towards a complete system of effective evaluation of life insurance costs and policies. Based on the interest-adjusted net cost index, it only provides for a comparison of similar policies. Furthermore it is only a "snap shot" representation of costs as of the date of annual compilation and is said to be obsolete "the minute it's off the press". Thirdly, its distribution has to date been limited as it was made available generally upon request or order to interested consumers. It was also sold in a few retail outlets. LUAC promised to advertise future editions in its newsletters in order to encourage purchase and use by agents. To date, use by agents has been minimal.

A further criticism of the Shoppers' Guide concept is that it fails to provide cost information on an individualized basis. It is maintained that effective cost disclosure must be individualized to disclose cost information on the specific policy being considered by the consumer.

Despite its shortcomings, the annual publication of a Shoppers' Guide or pricing guide provides Ontario consumers with a reference document or "yardstick" against which to measure the significance of interest-adjusted cost index figures provided to them by their own insurance companies.

## **F. DEVELOPMENTS IN THE UNITED STATES**

As a perspective on the developments in Ontario and across Canada in regard to cost comparative information for life insurance purchases, it is useful to examine developments in the United States.

### **1. History—Industry, State and Consumer Interest**

Cost disclosure and meaningful price information has attracted considerable interest in the United States. Criticism of poor or non-existent methods of cost evaluation arose strongly in the United States in the 1960's. A major factor in sparking debate was the publication in 1966 of a book by Dr. Joseph Belth, titled "The Retail Price Structure of Life Insurance".



Also noteworthy was the attention drawn in 1968, to the need for veterans returning from the Vietnam war to have some way of comparing cost on similar policies in converting to permanent life insurance.

In 1970, a Joint Special Committee on Life Insurance Costs was established by the then American Life Convention, the Institute of Life Insurance and Life Insurance Association of America, all industry associations now part of the American Council of Life Insurance. This committee considered various methods of cost comparison that had come into prominence up until that time. The three major categories of cost comparison and the specific cost methods considered by the committee were the following:

- (a) methods that determine an insurance cost index, having assumed an interest rate:
  - the traditional method, the interest rate implicit in this approach being zero,
  - the interest-adjusted method,
  - Professor P. L. J. Ryall's method, which allows for mortality as well as interest,
  - Professor Joseph M. Belth's level price method, which allows for interest, mortality and lapse factors,
  - the Lewis modification of the level price method,
  - benefits cost method, which is an extension of the level price method,
  - present value of premiums method developed by C. L. Trowbridge;
- (b) methods that determine an interest rate yield having assumed a cost of insurance:
  - the Linton yield method, which compares the results at the end of a specified period of having placed a stated annual amount in either (i) the premium less the dividend for a whole life policy or (ii) part in the premium less the dividend for a term policy, the remainder in an outside savings fund,
  - Professor Schwarzchild's and other modifications of the Linton method;
- (c) methods that relate the values of amounts paid by the company to amounts paid by the policyholder:
  - benefit-to-premium ratio method, which is an adaptation of the "loss-ratio" index commonly used for annual property insurance,
  - excess of value of premiums over value of benefits,
  - three cost index method suggested by Mr. Harold W. Baird.

In evaluating all these methods, the committee agreed that the interest-

adjusted method was the most suitable of all those studied, for the following reasons:

- it takes time of payment into account;
- of all the methods that take time into account it is the easiest to understand;
- it is possible to use this method without having recourse to advanced mathematics;
- it does not suggest a degree of accuracy that is beyond that justified by the circumstances;
- it is sufficiently similar to the traditional method so that transition could be accomplished with minimum confusion.

It is apparent that the committee found no simple obvious or “true” solution to price information for life insurance despite the many cost methods then known to the committee. Rather it decided on what it considered to be a practical approach to cost comparison in the use of the interest-adjusted net cost index.

The Joint Committee report met, however, with less than unanimous agreement within the industry. The interest-adjusted net cost method was criticized, for example, because it was being used by some people to compare different types of policies, contrary to its purpose. Objections were also raised to cost comparison in general as it was said such comparison would downgrade the role of the agent.

Nevertheless, interest in cost comparison increased.<sup>1</sup> Pennsylvania Insurance Commissioner Herbert Denenberg and Wisconsin Insurance Commissioner de Rose were active in adopting use of the interest-adjusted method, *renamed the surrender index*,<sup>2</sup> in life insurance shoppers’ guide for state consumers.

The National Association of Insurance Commissioners set up a committee to draft model state regulations pertaining to cost disclosure. Eleven projects were set up to study cost comparison methods between 1973 to early 1976. In 1976, NAIC adopted a final life insurance cost disclosure regulation which called for insurance companies to furnish consumers with interest-adjusted indices on request. The cost disclosure requirement was merged with regulations to control deceptive sales practices in a “life insurance solicitation model regulation”. The Committee learned in September 1979 during its hearings that 28 states had adopted the NAIC regulation with an additional 6 or 7 expected to join in by the end of 1979.

The interest-adjusted index has also been gaining public recognition as

1. As indicated earlier, interest in Canada increased also and resulted in the CLIA recommendations that an interest-adjusted cost index be provided to consumers on their request.  
2. The surrender index should not be confused with the surrender cost index sometimes used in reference to the net cost index which is the traditional method of cost comparison.

a result of shoppers' guides issued by organizations such as the Consumers Union and some state insurance departments. A new Consumers Union shoppers' guide made available in March 1980 uses the interest-adjusted index in new ways; it looks at the index over intervals of time and not just for the standard 10 year and 20 year durations. This new approach is meant to overcome the problem of manipulation of premiums, dividends and cash values to produce favourable results at standard periods of cost comparison.

## 2. Federal Interest

Alongside the development of the NAIC "life insurance solicitation model regulation", federal interest in cost disclosure increased in the United States. In recent years U.S. federal investigations into life insurance practices with focus on the matter of cost disclosure, have centred on:

- the 1973 and 1974 hearings on practices in the life insurance industry, of the United States Senate Subcommittee on Antitrust and Monopoly, chaired by the late Senator Philip A. Hart;
- the December 1978 report on life insurance marketing and cost disclosure, of the United States Congress Subcommittee on Oversight and Investigations, chaired by former Congressman John E. Moss;
- the May 1979 hearings on cost disclosure in life insurance, of the United States Senate Subcommittee on Antitrust, Monopoly and Business Rights, chaired by Senator Howard A. Metzenbaum;
- the staff report to the Federal Trade Commission on Life Insurance Cost Disclosure released in July 1979.

These hearings and reports have for the most part:

- reaffirmed the importance to the consumer of the availability of an effective measure of the cost of his life insurance policy;
- recommended against use of the traditional net cost method for comparing the costs of one life insurance policy with another, on the basis that this method is deceptive in failing to take into account the time value of money;
- advocated a cost index number or numbers and associated "yardstick" data, designed to show how one policy compares on an interest-adjusted basis to other similar policies;
- pointed out the need for a method of comparing dissimilar policies.

Disagreements did arise among the studies on the type of cost index number or numbers to be used and on certain other aspects of cost disclosure. In particular the staff report to the Federal Trade Commission addressed the provisions in the NAIC model regulation and presented recommendations to modify the NAIC model regulation. A brief overview of the

NAIC model regulation and the recommendations of the staff report to the Federal Trade Commission follows.

### 3. The NAIC Regulation and FTC Staff Report Recommendations

The NAIC regulation requires that insurance companies give purchasers two documents at the time their new policies are delivered:

- a “buyers’ guide”, which contains *general information* about life insurance, and
- a “policy summary”, which sets forth the basic *financial information* about the policy and cost indices used to compare the costs of similar policies.

The recommendations in the FTC staff report and critique of the cost comparison data in the NAIC model regulation, as outlined to the Committee during its hearings, are such:

1. The FTC report argued that the NAIC model regulation does not provide consumers with the information necessary:

- to evaluate cash value insurance as a savings vehicle; and
- to compare dissimilar types of insurance policies.

Such information is said to be required to identify clearly the consequences of using insurance for savings purposes.

For these purposes, the FTC staff report recommended disclosure of the average annual *rate of return* on cash value insurance and annuity products.

The FTC staff report recommended what is known as the “Linton Yield” as the method for rate of return disclosure. The Linton Yield is a compound annual rate of return on gross premiums paid over a selected holding period.<sup>1</sup>

2. The NAIC regulation prohibits the use of any cost disclosure method which does not recognize the time value of money. It requires the use of the interest-adjusted cost method (surrender index). This index must be provided in every policy summary. In addition to the surrender index, two other indices are required:

- the payment index;
- the equivalent level annual dividend.

1. The Linton Yield is calculated by deducting from the whole life premium, less any dividend, the amount it would cost to buy as much term as is represented by the policy’s pure insurance portion. The difference can be considered as a savings fund. By repeated trials it is determined what compound interest rate would have to be earned on the savings fund so that the fund at the end of the period chosen for computation would be equal to the cash value of the whole life policy. The Linton Yield is essentially an internal rate of return measure.

The Staff Report to the Federal Trade Commission on “Life Insurance Cost Disclosure” provides technical notes on the calculation of the Linton Yield in Appendix VI.



Each of these indices must be displayed for the tenth and twentieth years. This results in disclosure of six indices.

The FTC staff report concluded that the NAIC proposal presents the prospective purchaser with a bewildering array of index numbers. After some analysis, the FTC recommended retention of the surrender index, for the twentieth policy year only.

The FTC choice of the surrender index was made after consideration of the company retention index<sup>1</sup> as an alternative. A key advantage of the company retention index was said to be its lesser potential for manipulation by the altering of the patterns of cash values and terminal dividends.<sup>2</sup>

Neither index, however, provides any protection against the manipulation of illustrated dividend scales. As a result, the FTC staff report drew attention to the need for active supervision by state regulators of dividend manipulation.

Despite serious concerns about the surrender index, the FTC recommended its retention primarily based on the fact that this index is currently in fairly widespread use.

3. The FTC staff report stated that the twentieth year surrender index on its own is not enough. The consumer needs to compare one company's index against the indices of other companies. He needs a "yardstick" display of high and low indices for various companies.

The FTC staff report recommended that a range of surrender indices be provided for a representative sample of different types of policies to serve as a "yardstick" or gauge against which to measure the twentieth year surrender cost index.

In the absence of a surrender index-yardstick approach, the FTC staff report suggests the use of the Linton Yield to compare similar as well as dissimilar cash value insurance policies. The Linton Yield, as a rate of return, is said by the FTC staff report to have an independent meaning to

1. The FTC staff report describes the surrender index and the company retention index as follows:  
The *surrender index* is the best known of what is termed the "event specific" or "snapshot" approach to similar policy comparison. This technique looks at a particular point in time and assumes a specific event will occur. For example, the 20th year surrender index will show the relative cost of two policies based on the assumption that they are surrendered for their cash values after the policies have been held for twenty years.  
The *company retention index* is an example of the "group average" approach. This method looks at each policy year and, through the use of average probabilities of lapse and surrender, determines the likelihood that any policy payment—premiums, dividends, cash value or death benefits—will be made. These "expected values" are combined into an index which can be described as a representation of the average cost of a policy to a group of similar policyholders. (The company retention index was developed by Dr. Belth.)
2. The Canadian Institute of Actuaries also conducted an unpublished study of cost comparison methods, in which it found the company retention index to be less subject to manipulation than the other methods proposed. The report of the CIA Committee on Cost Comparisons recommended the company retention method as the single cost comparison index.

consumers in the manner of interest rates on deposits and other investments.<sup>1</sup>

4. The FTC staff report recommended other modifications to the NAIC regulation. Under the NAIC regulation, purchasers receive the disclosure package when the policy is delivered; a 10-day “cooling off” period allows purchasers to cancel if not satisfied.

The FTC staff report recommended a two-part disclosure:

- a buyer’s guide and a *preliminary* policy summary be given prior to an application;
- more detailed yearly financial information be provided in a policy summary to be delivered with the policy.

The FTC staff report elaborated on the types of information to be included in the buyers’ guide, preliminary policy summary and final policy summary.

5. The FTC staff report addressed further topics with respect to a disclosure system, including information in addition to index numbers, applicability of disclosure regulation to various lines of business and enforcement provisions. These topics will be subjects of discussion in the next chapter of this Report.

The insurance departments of Massachusetts, North Carolina and Wisconsin have attempted to enact cost disclosure systems that follow the FTC approach outlined above rather than the NAIC model regulation approach. However, serious challenges have been levelled at the attempts to enact these laws, such that in North Carolina, the NAIC model regulation was passed in lieu of the proposals of the Department of Insurance and, in Wisconsin, a court suit stopped implementation of the Wisconsin Department of Insurance Life Insurance Buyer’s Guide. A revised guide is also being challenged in the courts.

#### 4. Rigorous Disclosure

Neither the NAIC model disclosure regulation nor the FTC modifications to that regulation produce the type of rigorous cost disclosure advocated in recent years by Dr. Joseph Belth. The Committee welcomed Dr. Belth’s presentation of his views before the Committee during its public hearings.

In regard to the NAIC cost disclosure regulation, Dr. Belth states:

- the NAIC model provides for no breakdown of the protection and savings elements of the policy;
- the NAIC model provides for no rate of return information;

1. It might be noted that the Consumers Union in the U.S. published a guide in March 1980 to rates of return on cash value policies.

- the NAIC model provides for no disclosure of the cost of paying premiums other than annually;
- the NAIC model does not prescribe a precise format for disclosure.

For the most part these concerns are taken into account in the FTC recommended modifications, but the following shortcomings are still of concern to Dr. Belth:

- neither proposal provides for periodic disclosure to policyholders after the sale;
- neither proposal provides for price information beyond 20 policy years;
- neither proposal provides for yearly price information at the point of sale.

Professor Belth illustrated the reasons why, in his opinion, a more rigorous cost disclosure system is required than advocated by either the NAIC or the FTC. He outlined to the Committee examples of deceptive sales practices and manipulation of information which can occur without a mandated rigorous system of disclosure.

Professor Belth then provided the Committee with an illustration of the kind of information which he believes should be disclosed at the point of sale. Tables 4 and 5 are examples provided by Dr. Belth to indicate the yearly information and the summary information, respectively, to be provided to consumers purchasing a new policy. No explanation is attempted here of the calculations involved in deriving the cost indices or rates of return used by Dr. Belth. A brief explanation follows of the concepts stressed by Dr. Belth in a rigorous system of cost disclosure.

Dr. Belth stresses, in referring to the yearly information form, the importance that:

- yearly data be provided;
- the data be provided well past the 20th policy year; and
- a yearly rate of return be included in the cost illustration.

Dr. Belth further stresses that this information be provided to prospective policyholders and also to existing policyholders, viewed prospectively from the nearest anniversary of the policy.

With disclosure in full of the cost data outlined in Tables 4 and 5 Dr. Belth contends that purchasers of life insurance policies will be able to compare effectively, similar types of life insurance policies, dissimilar types and also life insurance products with other forms of investment and saving. He further contends that rigorous disclosure will create more rigorous competition.

Dr. Belth's system of rigorous cost disclosure has been criticized strongly because of its complexity and reliance on cost index and rate of re-



turn calculation unfamiliar to the average consumer. Dr. Belth admits that only a relatively few consumers will use or analyze a detailed cost illustration. However, he contends that increased competition will be fostered by agents. In being required to justify irregular patterns of rate of return or generally low rates of return, agents in Dr. Belth's opinion will pressure their companies to drop unattractive policies or in the extreme they will switch companies to ones with more attractive products. Because insurance companies compete for agents, Dr. Belth believes that agent-initiated response to cost illustrations will improve the product mix in the life insurance market.

However, Dr. Belth has met with little response or willingness to accept his system of rigorous cost disclosure among the state regulators of insurance in the United States. As a result, Dr. Belth has recently proposed that a distinction be made between "raw data" to be provided to policyholders and "derived data".<sup>1</sup> Dr. Belth recommends that, at the least, the purchaser of a life insurance policy be able to obtain a disclosure statement containing complete raw data about the policy and riders being purchased, this raw data to include for each policy year for 30 policy years or to age 75, whichever is the longer:

- the yearly premium by age;
- the amount payable on death;
- the amount payable on surrender;
- the illustrated dividend;
- any other significant cash benefit.

Furthermore, Dr. Belth proposes these data need be provided only upon request when a new policy is being purchased, and upon request and upon payment of an appropriate fee not to exceed \$5, when an existing policyholder wishes to obtain this information.

It is Dr. Belth's expectation that mandatory disclosure of raw data only will serve as a preliminary step in the development of a meaningful disclosure system. Dr. Belth anticipates that some mechanism will develop in the private sector which will process the raw data and produce the derived data needed for comparison.

A final matter addressed by Dr. Belth is that of dividend manipulation. In this regard, Dr. Belth has put forth the following recommendation:

"That appropriate steps be taken to require each company with individual participating life insurance in force to file each year . . . a copy of the full text of its most recent dividend resolution, including all actuarial memoranda and any actuary's report, so as to accomplish full public disclosure of its practices and procedures relating to the determination of dividends on its new and existing individual life insurance policies."

1. Raw data are illustrated in columns 1 to 6 of Table 1, derived data are illustrated in columns 7 to 9 of Table 1.



TABLE 4

\$25,000 NON-PARTICIPATING PRESIDENT'S PREFERRED LIFE POLICY  
ISSUED BY GULF LIFE IN 1977 TO MAN AGED 35

## YEARLY INFORMATION

(1) Policy Year	(2) Age at Beginning of Year	(3) Yearly Premium	(4) Amount Payable on Death	(5) Amount Payable on Surrender	(6) Illustrated <sup>a</sup> Dividend	(7) Amount of <sup>b</sup> Protection	(8) Yearly <sup>c</sup> Price	(9) Yearly Rate of Return <sup>d</sup>
1	35	\$455	\$25,000	\$ 41	\$0	\$24,959	\$ 17.52	-
2	36	455	25,000	404	0	24,596	4.80	-
3	37	455	25,000	820	0	24,180	3.46	-
4	38	455	25,000	1,247	0	23,753	3.94	-
5	39	455	25,000	1,687	0	23,313	4.46	5.09%
6	40	455	25,000	2,138	0	22,862	5.07	4.79
7	41	455	25,000	2,601	0	22,399	5.71	4.61
8	42	455	25,000	3,075	0	21,925	6.40	4.47
9	43	455	25,000	3,562	0	21,438	7.13	4.39
10	44	455	25,000	4,061	0	20,939	7.95	4.31
11	45	455	25,000	4,597	0	20,403	7.63	4.80
12	46	455	25,000	5,147	0	19,853	8.57	4.68
13	47	455	25,000	5,710	0	19,290	9.62	4.59
14	48	455	25,000	6,287	0	18,713	10.76	4.50
15	49	455	25,000	6,878	0	18,122	12.00	4.43
16	50	455	25,000	7,483	0	17,517	13.38	4.37
17	51	455	25,000	8,102	0	16,898	14.91	4.30
18	52	455	25,000	8,737	0	16,263	16.54	4.26
19	53	455	25,000	9,387	0	15,613	18.35	4.22
20	54	455	25,000	10,054	0	14,946	20.37	4.18
21	55	455	25,000	10,508	0	14,492	38.09	1.99
22	56	455	25,000	10,960	0	14,040	41.17	1.98
23	57	455	25,000	11,410	0	13,590	44.46	1.98
24	58	455	25,000	11,856	0	13,144	48.01	1.97
25	59	455	25,000	12,299	0	12,701	51.81	1.97
26	60	455	25,000	12,736	0	12,264	55.96	1.96
27	61	455	25,000	13,170	0	11,830	60.33	1.96
28	62	455	25,000	13,597	0	11,403	65.09	1.96
29	63	455	25,000	14,019	0	10,981	70.16	1.95
30	64	455	25,000	14,434	0	10,566	75.63	1.95
31	65	455	25,000	14,842	0	10,158	81.57	1.94
32	66	455	25,000	15,241	0	9,759	87.95	1.94
33	67	455	25,000	15,631	0	9,369	94.86	1.93
34	68	455	25,000	16,010	0	8,990	102.28	1.92
35	69	455	25,000	16,379	0	8,621	110.23	1.91
36	70	455	25,000	16,736	0	8,264	118.68	1.90
37	71	455	25,000	17,084	0	7,916	127.52	1.91
38	72	455	25,000	17,422	0	7,578	136.78	1.92
39	73	455	25,000	17,754	0	7,246	146.46	1.95
40	74	455	25,000	18,079	0	6,921	156.83	1.98

a Neither estimates nor guarantees, but merely illustrations of the company's 1977 dividend scale.

b Amounts payable on death (col. 4) minus amounts payable on surrender (col. 5).

c Yearly prices per \$1,000 of protection, assuming a 5.25 percent rate of return on the savings element.

d Yearly rates of return on the savings element, assuming yearly prices per \$1,000 of protection equal to 105 percent of the one-year term insurance rates in Revenue Ruling 55-747.

**TABLE 5**  
**\$25,000 NON-PARTICIPATING PRESIDENT'S PREFERRED LIFE POLICY**  
**ISSUED BY GULF LIFE IN 1977 TO MAN AGED 35**

**Summary Information**

Present expected values: <sup>a</sup>	
Premiums .....	\$5,291
Components of the Premiums:	
Protection element .....	\$1,073
Savings element .....	2,226
Illustrated dividends .....	0
Company retention .....	1,992
Total .....	\$5,291
Supplementary premiums:	
Waiver of premium .....	\$ 160
Ratio of benefits to premiums: <sup>b</sup> .....	62.4%
Average annual rates of return: <sup>c</sup>	
5-year average .....	-2.80%
10-year average .....	2.36%
20-year average .....	3.78%
40-year average .....	2.71%
Annual percentage rates:	
Semi-annual premium .....	10.3%
Quarterly premiums .....	13.4%
Regular monthly premiums .....	17.2%
Special monthly premiums .....	6.4%
Loan clause .....	6.0%

<sup>a</sup> The assumptions used in the calculation of these figures are 5.25 percent interest, the 1957-60 ultimate basic mortality table for males, and Moorhead's modified R lapse table.

<sup>b</sup> The numerator of the ratio is the sum of the present expected values of the protection element and the savings element. The denominator of the ratio is the difference between the present expected values of the premiums and the illustrated dividends.

<sup>c</sup> Average annual rates of return on the savings element, assuming one-year term insurance rates equal to those in Revenue Ruling 55-747.

## 5. Summary

In sum, the foregoing overview of developments in the United States points out, foremost, the importance attached to cost disclosure among consumers and regulators in that country. It also outlines some of the disagreements and discussions over appropriate forms of cost disclosure.

## G. THE LUAC PROPOSAL FOR DISCLOSURE OF PRICE-RELATED INFORMATION

In its submission to the Committee, LUAC commented that in its view the major need for disclosure is with regard to the year to year change in the costs and benefits of a life insurance policy. In LUAC's view this can best be accomplished by a "ledger statement" similar to the one which appears in Table 6 on the next page. LUAC's proposal is detailed further on Table 7 facing Table 6.

## LUAC PROPOSED LEDGER STATEMENT

ABC LIFE INSURANCE COMPANY

NAME OF POLICY - Whole Life - Dividends  
to purchase paid-up  
additions

NAME OF LIFE INSURED

AGE OF LIFE INSURED 30

This ledger statement DOES NOT  
FORM PART OF THE CONTRACT WITH  
THE POLICYOWNER

FACE AMOUNT OF CONTRACT \$25,000

BASIC PREMIUM - \$424.50 annually

POLICY NUMBER

DATE OF ISSUE

(1) End of Policy Year	(2) Age	(3) Sum of Basic Premiums Paid to Date	(4) Basic Death Benefit Including Paid-up Additions	(5) CASH VALUES		(6) PAID-UP VALUES		
				a Guaranteed	b Paid-up Additions	Total Cash Value	a Guaranteed	b Paid-up Additions
1	31	\$ 424.50	\$ 25,194	\$ 0	\$ 55	\$ 55	\$ 0	\$ 194
2	32	849.00	25,416	112	121	233	350	416
3	33	1,273.50	25,663	432	198	630	1,325	663
4	34	1,698.00	25,937	760	289	1,049	2,300	937
5	35	2,122.50	26,237	1,112	392	1,504	3,275	1,237
6	36	2,547.00	26,564	1,445	510	1,955	4,150	1,564
7	37	2,971.50	26,916	1,792	644	2,436	5,000	1,916
8	38	3,396.00	27,295	2,147	794	2,941	5,850	2,295
9	39	3,820.50	27,701	2,532	961	3,493	6,725	2,701
10	40	4,245.00	28,133	2,910	1,146	4,056	7,525	3,133
11	41	4,669.50	xxxxxx	xxxxx	xxxxx	xxxxx	xxxxx	xxxxx
12	42	5,094.00	xxxxxx	xxxxx	xxxxx	xxxxx	xxxxx	xxxxx
13	43	5,518.50	xxxxxx	xxxxx	xxxxx	xxxxx	xxxxx	xxxxx
14	44	5,943.00	xxxxxx	xxxxx	xxxxx	xxxxx	xxxxx	xxxxx
15	45	6,367.50	30,696	4,897	2,392	7,289	11,150	5,696
16	46	6,792.00	xxxxxx	xxxxx	xxxxx	xxxxx	xxxxx	xxxxx
17	47	7,216.50	xxxxxx	xxxxx	xxxxx	xxxxx	xxxxx	xxxxx
18	48	7,641.00	xxxxxx	xxxxx	xxxxx	xxxxx	xxxxx	xxxxx
19	49	8,065.50	xxxxxx	xxxxx	xxxxx	xxxxx	xxxxx	xxxxx
20	50	8,490.00	33,949	7,010	4,275	11,285	14,175	8,949
25	55	10,612.50	37,944	9,145	6,985	16,130	16,475	12,944
30	60	12,735.00	42,694	11,397	10,707	22,104	18,425	17,694
35	65	14,857.50	48,248	13,585	15,545	29,130	19,975	23,248

This illustration is based on the assumption that all provisions of the policy as originally issued are continued in force without alteration, termination, or adjustment of any kind.

The "Sum of Basic Premiums Paid to Date" (Column 3) includes only the premium for the basic benefits illustrated above and does not include the premiums for the following optional benefits if elected by the policyowner:

- (i) Accidental Death Benefit
- (ii) Guaranteed Insurability Benefit
- (iii) Waiver of Premium
- (iv) Disability Income

The description of these options and the premiums payable therefor are set out in the policy.

The Death Benefit (Column 4) includes only the face value of the contract plus the face value of paid-up additions does not include any accidental death benefits which may be included in the contract.

The loan values are equivalent to 96% of the total cash value shown in column 5(c) above at the end of the applicable policy year.

All the figures shown except for the "guaranteed cash values" (column 6(a)) and the "guaranteed paid-up values" (column 5(a)) dividends which are based on the company's current dividend scale. They are illustrations only and must not be considered as either guarantees or estimates.

LUAC PROPOSED LEDGER STATEMENTBASIC INFORMATION

- the name of the life insurer
- the name of the life insured
- the age of the life insured
- a description of the type of insurance (i.e. whole life) and the dividend option elected, if applicable
- the face value of the contract
- the basic premium (indicating frequency of payment)
- the policy number
- the date of issue
- a warning that "This ledger statement DOES NOT FORM PART OF THE CONTRACT WITH THE POLICYOWNER".

COLUMNAR PRESENTATION

- (a) the policy year (see column 1 of Ledger Statement). Information to be presented for each of the first twenty years and for five year intervals thereafter to age 65 or life expectancy
- (b) attained age of life insured (at insurer's discretion) (see column 2 of the Ledger Statement)
- (c) sum of basic premiums paid to date (see column 3 of Ledger Statement)
- (d) basic death benefit which would include paid-up additions or accumulated dividends where applicable (see column 4 of Ledger Statement)
- (e) cash values
  - (i) guaranteed
  - (ii) of paid-up additions where applicable
  - (iii) total of cash values (see column 5 of Ledger Statement)
- (f) paid-up values
  - (i) guaranteed
  - (ii) of paid-up additions where applicable
  - (iii) total of paid-up values (see column 6 of Ledger Statement)
- (g) if alternate dividend options are elected (other than paid-up additions) the Ledger Statement should include data on:
  - (i) the net premium, if dividend applied as a premium reduction
  - (ii) an ascending figure to indicate dividends left with the company to accumulate at interest
  - (iii) if cash dividend - the amount of same
- (h) the following footnotes should also appear on the Ledger Statement:
  - (i) this illustration is based on the assumption that all provisions of the policy as originally issued are continued in force without alteration, termination, or adjustment of any kind
  - (ii) the "Sum of Basic Premiums Paid to Date" (Column 3) includes only the premium for the basic benefits illustrated above and does not include the premiums for the following optional benefits if elected by the policyowner:
    - 1) Accidental Death Benefit
    - 2) Guaranteed Insurability Benefit
    - 3) Waiver of Premium
    - 4) Disability Income

The description of these options and the premiums payable therefor are set out in the policy
  - (iii) the Death Benefit (Column 4) includes only the face value of the contract (plus the face value of paid-up additions or accumulated dividends where applicable) and does not include any accidental death benefits which may be included in the contract
  - (iv) the loan values are equivalent to a percentage of the total cash value shown in an appropriate column at the end of the applicable policy year
  - (v) all the figures shown except for the "guaranteed cash values" and the "guaranteed paid-up values" include dividends which are based on the company's current dividend scale. They are illustrations only and must not be considered as either guarantees or estimates



In many respects, LUAC's proposal for ledger statement information appears to the Committee to be not unlike Dr. Belth's proposal for a yearly information form, providing raw data only.

LUAC states,

"This one sheet display of all the pertinent figures on an annual and cumulative basis gives a much clearer and more complete picture than all the words in the policy and any other explanatory material that might be devised."

LUAC continues with the comment:

"The delivery of such a ledger statement along with the policy would have many advantages. At the time of policy delivery, the agent could easily and quickly use the ledger statement to review with the policyholder the essential facts about his policy. Moreover, the ledger statement would be invaluable for future reference both by the policyowner and the agent. It would assist in the agent's work of providing future service to the policyowner. Undoubtedly the problem of lapsation of life insurance policies would be reduced where the policyowner is enabled at any time to see at a glance the growing values as a result of his continued payment of premiums."

LUAC in its submission takes into account the availability of various cost indices for cost comparison but sees limitations in cost indices wherever they are used. It concludes that from the standpoint of disclosure, "there is no substitute for a ledger sheet giving a year by year display of premiums, dividends, values and benefits".

In regard to cost comparison, LUAC goes on to state that, based on the experience of its members:

"The average buyer of life insurance is not particularly interested in cost indices and comparison of costs among companies. Such interest in the cost of life insurance exists mainly in the area of group insurance, pension plans and large policies owned by corporations for business purposes.

Most purchasers of individual insurance are primarily interested in dealing with a competent agent who can evaluate their needs and recommend the best combination of policies for those needs. Where the matter of comparative costs arises, which is infrequently, the question normally relates to the comparative costs among different types of life insurance e.g. comparison of the cost of term insurance and whole life insurance."

This last comment by LUAC appears to indicate the need for an appropriate method of comparing *dissimilar* policies.

The Committee notes also that the CLIA has stated to the Committee that the raw data such as recommended by LUAC can be readily provided by Canadian life insurance companies.

## **H. OBSERVATIONS ON COST COMPARISON**

8.5 In studying the life insurance industry, the Committee has come to the general conclusion that price comparison must play an important role in the marketing of life insurance. Not only is price comparison essential to price competition but the importance of price information is magnified by the current inflationary environment and its effect on the value of life insurance benefits. Without meaningful price information, the consumer is unable to maximize his purchase of insurance coverage and hence minimize the effects of inflation on the death protection he buys.

8.6 Based on review of the elements of price and the various methods of cost comparison of life insurance products, the Committee concludes further, as a general statement, that an effective system of price comparison should include:

1. Mandatory disclosure of basic cost data, including:

- the yearly premium by age
- the amount payable on death
- the amount payable on surrender
- the illustrated dividend
- any other significant cash benefit,

to be provided for the basic policy and all supplementary benefits and riders.

2. Widespread use and availability of cost indicators that will permit life insurance buyers to compare the cost of similar life insurance policies. This suggests as well the need for a Shoppers' Guide type of publication as a "yardstick" for cost comparisons on the basis of currently recognized cost indices.
3. A measure of cost that will permit comparison of dissimilar policies.

However price information should not, in the Committee's opinion, be considered in isolation but rather in the context of comprehensive system of disclosure, a topic which the Committee intends to address in some detail in the recommendations which follow under Chapter 9.



**PART IV**  
**DISCLOSURE**





## CHAPTER 9

### Informing the Consumer

#### A. INTRODUCTION

##### 1. Difficulties in Purchasing Life Insurance

The preceding Parts of this Report, dealing with life insurance products and coverage and with the cost of insurance pointed out the complexities that consumers face in making an informed purchase decision for life insurance. The Committee has found that the buyer of a life insurance product is more vulnerable to a lack of knowledge with respect to this product than in regard to other products for the following reasons:

- the complexity of life insurance products and needs;
- the fact that decisions are made based on uncertainty about future contingencies;
- the lack of consumer motivation to research and learn about a product that is bought infrequently;
- little trial and learning with a life insurance product—claims on the product are distant from its purchase;
- the difficulty of understanding life insurance and annuity contracts;
- the problem of finding a suitable measure of cost to the policyholder.

Furthermore, the Committee finds that information requirements do not stop with purchase of a policy. A continuing need for information exists with respect to:

- policy renewal,
- policy replacement,
- termination of a policy for any one of a variety of reasons,
- selection of contract options, including cash value options, dividend options and settlement options.

In all cases, the consumer faces a choice of alternatives which he must evaluate to make a choice proper to his circumstances.

A 1977 survey of consumer attitudes in Canada towards life insurance points out some of the difficulties consumers face in buying a life insurance policy. This survey commissioned by the CLIA stated that “there is still considerable confusion clouding the appreciation of life insurance”. This statement was based on the following data.

These data added to the Committee’s findings during its studies into the life insurance industry point to the importance of informing and assisting the consumer in his purchase of a life insurance product.

## CONSUMER PROBLEMS ASSOCIATED WITH PURCHASING LIFE INSURANCE—1977

**Question:** Some people have difficulty with one aspect of life insurance or another. For each of the things listed, tell me whether or not you would have difficulty.

Points of Question	Answers—1,753 Respondents			
	A lot of Difficulty	Some Difficulty	Very Little Difficulty	None
Understanding the wording of the policy	35%	34%	14%	14%
Determining if you are getting your money's worth	24	38	16	18
Figuring out how much a particular policy will cost	18	36	22	21
Determining how much life insurance to buy	14	39	20	24
Deciding on the kind of life insurance policy you need	14	39	22	22

*Note:* Percentages do not add to 100 because "no answers" are excluded.

*Source:* Centre De Recherches Contemporaines Limitee, "Data Base II, Attitudes of the Canadian Public Towards Life Insurance", A Research Study Conducted for the Canadian Life Insurance Association, June 1977.

## 2. Disclosure Versus Marketing

The need for informing and assisting the consumer in his purchase of a life insurance product has been well recognized by the life insurance industry in Ontario. It has been approached, broadly speaking, in two ways: first, through advertising, notices, policy summaries, simplified policies and general consumer education materials—these methods might be grouped under the generalized heading of *disclosure*; and, secondly, through the development and training of an agency force to assist the customer on an individual basis—this method might be considered under the heading of *marketing*. Both approaches to informing the consumer are necessarily interdependent. Improved product literature and policy forms ease the burden of information to be provided by the agent; nevertheless the agent may be necessary to deliver or to interpret policy information to the consumer. This part of the Report concentrates on the subject of disclosure whereas the next part will deal with marketing.

## B. DUTY OF LIFE INSURERS TO INFORM THE CONSUMER

In Chapter Four, the Committee expressed the view that life insurance companies should have the responsibility, explicitly set out in The Insurance Act, to provide clear, meaningful information on the products they sell. Ac-

cordingly, the Committee recommended that Part V of The Insurance Act be amended to recognize the duty of life insurance companies to inform consumers about product characteristics salient to the choice of product alternatives. Further, the Committee recommended that the Act recognize the duty of the Superintendent to supervise life insurance companies in this regard.

In this Chapter, the Committee comments on its specific expectations about the types of information to be provided to consumers and the form of disclosure presentation.

## **C. NEED FOR A MANDATORY SYSTEM OF DISCLOSURE**

The Committee notes and welcomes the guidelines already issued by the CLIA pertaining to certain aspects of disclosure, including cost disclosure. But these guidelines are not strictly defined nor are they universally adopted or enforceable. Therefore, the Committee is concerned about the possibility that misleading information might be provided to the consumer, even if only inadvertently. The Committee believes that the potential for misleading information is strong given the complexities of life insurance products and their prices. Hence, the Committee recommends a mandatory system of disclosure of information in the sale of life insurance.

9.1 The Committee recommends, based on its study of the life insurance industry, that The Insurance Act be amended to provide for a system of mandatory disclosure, with a precise format for disclosure set out in regulations to The Insurance Act.

The Committee's study into life insurance has led it to conclude that the elements of information required by the consumer in a comprehensive mandatory disclosure system can be categorized under the following headings:

- information about life insurance as a means of financial protection and about the different types of life insurance; that is, **PRODUCT INFORMATION**.
- yearly information on premiums, dividends, amounts payable at death and amounts payable upon policy surrender; that is, **YEARLY DETAILED POLICY INFORMATION**.
- summary information applicable to comparison of the cost of similar policies among companies, for example, the company retention index; that is, **SUMMARY COST INDEX INFORMATION**.
- summary and yearly information on the cost of protection in each policy; that is, **COST OF PROTECTION INFORMATION**.
- summary and yearly information applicable to comparison of the cost of different cash value policies, that is, **RATE OF RETURN INFORMATION**.

In the Committee's opinion, the effective presentation of this informa-



tion requires that certain of the elements of information outlined above be provided:

- at the point of sale;
- at policy issue and delivery; and
- on a periodic, ongoing basis.

The form or format of mandatory disclosure which the Committee believes should be required for presentation of product and cost information at each of the above points of time is the subject of the following parts of this Chapter.

The following recommendations on a mandatory system of disclosure are based on the Committee's view that the consumer needs, first, to be alerted through disclosure, to the various features and benefit values of the policy he is considering buying and, secondly, that he needs to be provided with sufficient policy financial information that he can evaluate the policy in some detail if he should wish to do so. While not all consumers will make full use of the information provided in disclosure documents, the Committee believes that mandatory disclosure rather than disclosure upon request is a more effective means of stimulating more consumers to look carefully at what they are buying. For similar reasons, the Committee believes that mandatory disclosure should be as complete as possible.

#### **D. AT THE POINT OF SALE**

##### **1. "The Guide to Buying Life Insurance"**

9.2 The Committee recommends that each consumer receive at the point of sale, either from the agent or directly from the insurer, a "guide to buying life insurance".

This guide should be a short booklet in standardized form and should:

1. Be in simplified language and in easily readable format.
2. On the first page, list a series of important questions which the applicant should pose to his agent in order to make a life insurance purchase best suited to his needs.

Careful study should be given by the industry in cooperation with the Superintendent to determining which questions will be most appropriate for a life insurance buyer to ask. It should as well be indicated that information which will at least partly answer these questions will be found by reading through the guide.

Included as a question should be the following, as recommended in the previous Chapter: given a stated premium what amount of insurance does this premium buy under a participating policy and what amount does it buy under a non-participating policy?

3. Indicate that life insurance should not be bought without carefully assessing one's personal situation in regard to how much insurance should be bought and for what purposes.

For most people, life insurance is bought to protect dependants from economic hardship when the insured dies. The guide should point this out and should provide a brief example of how to go about an assessment of dependants' needs. The guide should state that individuals may benefit from the advice of an agent in determining amounts of insurance. Those with unusual financial situations should be advised to seek financial advice.

The guide should also indicate that a life insurance program should be reassessed frequently.

4. Indicate that the consumer think carefully before replacing a policy.

Reference should be made to what might be a "good" replacement and what might be a "bad" replacement. If a change is suggested, the consumer should be advised to ask the company which issued the old policy for information about the cash surrender value, if any, in his existing policy, and for further detailed policy information in order to compare his existing policy with the proposed new policy.

5. Explain the basic types of life insurance coverages and explain the level premium method of paying for life insurance.

Standard definitions of life insurance products, as recommended by the Committee in Chapter Four, should be used in the guide. This glossary of standard definitions should include at the least:

- whole life
- endowment
- renewable and convertible term
- non-renewable term
- decreasing term.

An explanation of the level premium method of paying for life insurance should be provided, referring to whole life, endowment and term insurance policies, as some types of term policies are also of the level premium type.

6. Explain that premiums alone do not always reveal the true cost of life insurance coverage.

The reasons for considering dividends, in determining the cost of a participating policy, should be explained.

The reasons for considering the amounts payable on surrender, in determining the cost of whole life and endowment policies, should be explained.

7. Explain generally the concept of using Cost Indicators to shop for the best price, with more detailed explanation of each Cost Indicator to be explained as outlined in the points below. As there is no one comprehensive measure of the cost of a life insurance policy, which permits comparison of similar policies and also dissimilar policies, the Cost Indicators to be explained in the guide should include:

- a Summary Cost Index, preferably the Company Retention Index
- a Cost of Protection index
- an Average Rate of Return on cash value policies.

The consumer should be told to look at the “‘point of sale policy summary” which he would have received with the “‘guide to buying life insurance” for the Cost Indicator numbers on the policy or policies he is considering.

8. Explain the concept of a Summary Cost Index in shopping for the best price. Two possibilities include the Company Retention Index and the Interest-Adjusted Net Cost Index.

The Committee will comment later on its views in regard to the type of Summary Cost Index to be provided to consumers.

An example should be provided in the guide of high and low index values indicating whether a high or low value shows a better cost. The Committee suggests that the following might serve the purposes of comparison in the “‘guide to buying life insurance”.

Example: \$10,000 Non-Participating Whole Life Policy—Male

	10 Year Cost Index		20 Year Cost Index	
Age 25	Low	xx	Low	xx
	High	xx	High	xx
Age 35	Low	xx	Low	xx
	High	xx	High	xx
Age 45	Low	xx	Low	xx
	High		High	xx

The guide should refer to an “‘annual survey of cost index ratings” for all whole life and term policies sold in this Province. This survey is to be of the type that has been made available by The Consumer’s Association of Canada under the title of a “‘Shoppers’ Guide to Canadian Life Insurance Prices”. The Committee will comment on the contents of and responsibility for this survey later in this Chapter.

9. Explain the concept of using a Cost of Protection index to shop for the best policy.

The guide should explain that in early years of a level premium policy only part of each premium paid for insurance is necessary to buy death protection in those years. It should be explained that a further part of the premium can be viewed as a deposit that builds up with interest and the resulting amount is used to offset the costs of death protection in later years when the price of protection is higher.

The guide should state that, in buying term insurance, the whole premium, aside from the loading for profit and expenses, buys yearly death protection, except in certain level premium term policies which may have a cash surrender value.

The guide should explain that the Cost of Protection index is intended to point out to the consumer the average cost of insurance per \$1000 of protection bought over specified periods of time.

The Committee will comment later, under the heading of the “point of sale policy summary”, on its further views regarding disclosure of Cost of Protection information.

10. Explain how the Average Rate of Return can be used to compare the cash value benefits of policies with this feature.

Included in these explanations should again be reference to the fact that in early years of a level premium policy only part of each premium paid for insurance is necessary to buy death protection in those years. It should be explained that a further part of the premium can be viewed as a deposit that builds up with interest. The resulting amount helps to offset the costs of death protection in later years but is also available as a cash value to the policyholder upon surrender of the policy. The Average Rate of Return shows approximately what rate of return the policyholder will get on the cash value of his policy if the policy is surrendered at stated periods of time such as 5, 10, 20 or 30 years.

The Committee will comment later, under the heading of the “point of sale policy summary” on its further views regarding Rate of Return information.

11. Explain other features of life insurance that should be brought to the consumer's attention.

Included in this explanation might be:

- a) Supplementary benefits, to include at least the following:
  - waiver of premium rider
  - accidental death rider
  - guaranteed insurability option
- b) Features of the whole life policy
  - e.g. policy loans
- c) Dividend Options



d) Settlement Options

e) Exclusions

f) Commentary on Substandard Rates.

12. Include a final alert to consumers buying non-guaranteed policies, including

—adjustable benefit policies

—indeterminate premium policies,

to look carefully at these policies and obtain additional assistance from the agent.

## **2. The “Point of Sale Policy Summary”**

9.3 The Committee also recommends that, at the point of sale, each consumer receive a “point of sale policy summary”

This policy summary should:

1. Identify the policy by indicating the name of the company, the type of policy by its generic name, the name of the policy as used by the company in advertising, the amount payable at death, the policyholder’s sex and age at issue, and whether the policy is participating or non-participating.

2. State, for whole life or endowment insurance:

— the annual premium for a standard-rated risk

— the annual premium for supplementary benefits, these being identified separately as:

— waiver of premium rider

— accidental death rider

— guaranteed insurability option.

3. State, for term insurance or for term riders:

— the initial amount payable on death and the initial annual premium

— the amount payable on death for representative future policy years and the annual premium then payable

— the cash surrender value for representative future policy years, if available under a level premium policy

— whether the term insurance is renewable and, if so, through what age

— whether the term insurance is convertible and, if so, through what age.

4. State for whole life, endowment and term insurance, summary Cost Indicators for the policy being offered.

The Committee believes that the following three Cost Indicators for

life insurance provide the consumer with the comprehensive information needed to evaluate policy choices both among similar policies and among dissimilar policies. These measures are:

- a Summary Cost Index, preferably the Company Retention Index,
- the Cost of Protection, that is, the cost of the policy per \$1,000 of protection
- the Rate of Return on cash value policies.

Each of these measures of cost should be summarized over stated periods of time as an average Cost Indicator. To give consumers a better idea of how good a buy a policy would prove to be if held for various periods of time, the Committee believes that a display of average or index numbers should be provided for a 5 year, 10 year, 20 year and 30 year period.

The Committee further believes that these Cost Indicators would be most useful if provided first at the point of sale as well as at the time of policy issue when yearly financial information should be provided.

The Committee recognizes that to produce these measures of cost at the point of sale requires that such information be included in a "rate book" along with premium quotes, either in full for all issue ages and policy amounts or for representative ages and policy amounts. The Committee further recognizes that to produce these data efficiently requires that financial information on each plan of insurance be entered into computer files and that calculations be performed by computer. While this requirement may impose additional cost on some insurance companies, particularly on smaller companies, the Committee believes that such expenditures are a necessary cost to be borne by the industry in order to promote effective price competition in the insurance marketplace. The Committee believes that the use of computer technology is sufficiently developed to expect its use by the insurance industry for calculation of summary Cost Indicators, as such use would be in the long-term interests of policyholders and prospective policyholders in this Province.

The Committee urges life insurance companies immediately to start examining ways of including data on Cost Indicators in their rate books. The Committee is aware that some companies already provide data on the net payment index and the interest-adjusted net cost index in their rate books, in accordance with CLIA guidelines that these Cost Indicators be made available to the public. A similar display of information for the other required Cost Indicators should also be included in company rate books for use by the agent in filling out the "point of sale policy summary".

Further comments on each Cost Indicator follow.

#### *The Summary Cost Index*

As stated, the Summary Cost Index should be provided at specified

periods of time, such as 5, 10, 20 and 30 years. Two possibilities for use as the Summary Cost Index include the Company Retention Index and the Interest-Adjusted Net Cost Index.

The Committee is of the view that the Company Retention Index is a meaningful method of comparing similar policies at the point of sale. It measures how much, in present value terms, policyholders on the average can expect the company to retain out of their premium payments for expenses and profits. The amount not retained is used for provision of protection and cash value benefits.

Disclosure of total "company retention" is in the Committee's opinion preferable to disclosure of agents' commissions which are only one component of the total retention of premium contributions for other than protection and cash value benefits.

The Committee notes that the Canadian Institute of Actuaries has recommended the Company Retention Index as the single cost comparison index, indicating that it is less subject to manipulation than other cost index methods for comparison of similar policies.

The Committee finds that the Interest-Adjusted Net Cost Index would be possible, although less meaningful, alternative form of Summary cost Index for point of sale disclosure. The Interest-Adjusted Net Cost Index has in its favour:

- simplicity;
- recognition by the industry in Canada;
- current usage, in that it is already provided by most companies on request of the policyholder;
- apparent commitment of the life insurance industry to publication of an annual survey and rating of policies based on the interest-adjusted net cost index. This survey will serve as a "yardstick" against which to compare the Summary Cost Index number of individual policies.

The Committee recommends the choice of the Company Retention Index as the Summary Cost Index for point of sale disclosure.

### *Cost of Protection*

The Committee believes that some measure of the Cost of Protection is essential to the consumer at the point of sale.

A question that a consumer is likely to ask in deciding what kind of insurance to buy once he knows how much he needs, is—"What is the cost of this policy for every \$1,000 I get in protection?"

For a cash value policy the amount of protection is defined as the amount payable on death minus the amount payable on surrender. For a term policy without cash value it is simply the amount payable on death.

The Committee finds that the Cost of Protection can be derived using a method similar to that used in deriving the Company Retention Index, advocated by the Canadian Institute of Actuaries. For cash value policies, it necessitates only that the calculation be based on the present expected value of the protection element only, rather than on the sum of the present expected values of the protection element and the cash value element of the policy. This difference does not arise in the case of most term policies.

The resolution of an appropriate measure of the Cost of Protection should be undertaken by the industry and the Superintendent. The Committee points out however that it finds the methodology of the Company Retention Index a useful precedent towards Cost of Protection calculation.

### *Rate of Return*

The Committee believes that it is essential to provide the consumer at the point of sale with some measure of the rate of accumulation of cash values in his policy. The Committee believes that an Average Rate of Return on cash value policies would be a suitable Cost Indicator for these purposes.

The Committee is of the view that an Average Rate of Return expressed as a percentage is a familiar measure of accumulation and hence generally understandable in comparing the quality of a wide range of products.

In order to give the consumer some idea of how good a buy a whole life or other cash value policy is if surrendered at various times in the future, the Committee believes that the Average Rate of Return should be provided for 5, 10, 20 and 30 years.

The resolution of an appropriate measure of an Average Rate of Return should be undertaken by the industry and the Superintendent.

5. In the case of an adjustable benefit or new money policy, point out that the amounts payable upon death are not guaranteed. As these policies are often funded by a single premium, substantial disclosure must be provided at the point of sale.

Illustrate the amount of extra insurance payable if market rates of interest rise in the future; illustrate the amount of extra premium which would be required to maintain a constant amount payable upon death if market rates of interest fall in the future.

State the guaranteed minimum amount payable at death.

Examples of the Committee's thinking in regard to "point of sale policy summaries" are appended at the end of this Chapter for whole life and endowment insurance, for term insurance and for adjustable benefit poli-



cies. These examples might act as a guide to the industry and the Superintendent; but they are not intended to represent the final versions of what should be provided to the consumer in terms of practical, meaningful policy summaries.

### **3. Summary of Point of Sale Disclosure**

9.4 The Committee recommends that the distribution of a standardized “guide to buying life insurance” and a “point of sale policy summary” be made mandatory by amendments to The Insurance Act. Both documents should be provided at the time of:

- application when dealing personally with an agent or life insurance sales representative or when selling single premium life insurance;
- within 10 days after application when buying life insurance through the mail or by telephone.

The agent should be required to complete the “point of sale policy summary” form when he takes an application.

9.5 The Committee recommends that the life insurance industry together with the Superintendent should cooperate in drafting an appropriate guide and policy summary in a form that is meaningful to the consumer. The Committee is confident that the industry is fully capable of carrying out this important task. The Superintendent should approve the efforts of the industry before implementation. If the industry fails to reach consensus on a guide and point of sale policy summary, the Committee recommends that this task be undertaken by the Superintendent.

9.6 The Committee recommends that the cost of printing and distribution of point of sale disclosure documents should be borne by life insurance companies. In the event the Superintendent is required to produce the disclosure documents, the costs of such production should be allocated among life insurance companies in proportion to the amount of business they write in this Province.

9.7 The Committee has recommended that the following three Cost Indicators be provided to the consumer at the point of sale of a life insurance policy:

- the Company Retention Index
- the Cost of Protection
- the Average Rate of Return on cash value policies.

However, as an interim measure before implementation of the disclosure system outlined in this Chapter, the Committee recommends that the life insurance industry undertake without further delay to state to each prospective policyholder at the point of sale the Interest-Adjusted Net Cost Index for the policy being proposed for his needs. An explana-

tion of the use of this index should also be provided and reference should be made to the industry-sponsored survey of life insurance prices which the Committee expects the industry to publish before the end of this year.

## **E. TIME OF POLICY ISSUE**

The Committee believes that it is essential that the consumer obtain as complete as possible financial information on the life insurance policy being purchased. Although it may be argued that few consumers will be capable of or will take the time to evaluate their policies on the basis of full financial information on policy values and costs, the Committee believes such information is essential to a competitive marketplace for life insurance. The Committee further expects that full disclosure of financial information will foster competition through the intermediary of the agent. The Committee urges the agent to request that his sponsoring insurer justify generally poor or irregular policy values. The Committee hopes that through such agent pressure, companies will find it necessary to drop unattractive policies.

9.8 As a further mandatory disclosure requirement, the Committee recommends that detailed yearly financial information be provided to the purchaser of life insurance at the time of policy issue in the form of a detailed policy information document.

The Committee recommends that this mandatory detailed policy information document contain yearly information on:

- the premium by age;
- separately, the additional amount of premium payable for a risk rated as substandard, by age;
- the amount payable on death;
- the amount payable on surrender, if any;
- the illustrated dividend, if any;
- any other significant cash value benefits, such as paid up insurance;
- any significant use of dividends, for life insurance benefits, such as additions to the amount payable on death and the amount payable on surrender.

This yearly display of information should be provided for 30 years or to age 75 whichever is the longer period.

The Committee has reviewed the proposal submitted by LUAC for disclosure of "ledger sheet data" on a year by year basis of premiums, dividends, cash values and benefits. The Committee finds that the illustration submitted by LUAC is generally suitable for disclosure purposes, but somewhat complex in display and heading terminology and should be simplified.

As an example of the Committee's thinking on this matter, sample detailed policy information documents are appended at the end of this Chapter. The Committee is nevertheless confident that the industry will be able to develop a clearer, more understandable terminology and graphic design for these documents and urges the industry to cooperate in this regard.

- 9.9 The Committee also recommends that the detailed display of financial information include, on a year to year basis, a measure of the amount of protection bought by the premium, the yearly price per \$1,000 of protection and, for cash value policies, the yearly rate of return.

By the amount of protection is meant the amount payable on death minus the amount payable on surrender. The Committee expects that the insurance industry and the Superintendent will undertake to study the various methods of determining yearly rate of return and yearly price per \$1,000 of protection and agree upon an acceptable, uniform method. Further comments follow below.

- 9.10 The Committee further recommends that a summary of the detailed financial information should be provided at the time of policy issue, including as applicable the Company Retention Index, at specified periods of time, such as 5, 10, 20 and 30 years; the Cost of Protection, that is, the average cost of the policy for \$1,000 of protection if the policy is held for 5, 10, 20 and 30 years; the Average Annual Rate of Return on cash value policies, if surrendered at 5, 10, 20 and 30 years.

This summary will duplicate some of the information on the "point of sale policy summary" for new policyholders but it will update and perhaps adjust this information for existing policyholders when provided as part of ongoing disclosure. Ongoing disclosure will be described later in this Chapter.

### *Rescission Rights*

- 9.11 The Committee further recommends that a right of rescission during the 10 day period after policy issue and delivery be guaranteed to life insurance policyholders in The Insurance Act.

That is, policyholders should have the right to return the policy within ten days of delivery and receive a full refund of premiums paid. The Committee welcomes the industry's initiative in this direction as exemplified by the CLIA guidelines that a 10-day rescission right be given by member companies. However, the Committee believes that the 10-day rescission right must be a fundamental component of any effective disclosure system which relies on detailed financial information being provided at the time of policy delivery. Hence the Committee believes that a 10-day "free look" should be required in statute of all insurers in this Province selling whole life, endowment and term insurance to individuals.

As recommended in Chapter 4, the Committee believes the rescission right should be extended to 20 days in regard to policy replacements.

## F. ONGOING DISCLOSURE

The long-term nature of whole life contracts and certain term insurance necessitates, in the Committee's view, that policyholders be informed or reminded of the status of their life insurance programs at periodic intervals.

- 9.12 The Committee recommends that at policy renewal or every 5 years, whichever is less, policyholders receive an updated, detailed policy information document and summary identical to that delivered to the policyholder at policy issue.

Outlined in the ongoing disclosure documents should be:

- yearly data on premiums, dividends, amount payable on death, amount payable on surrender, and amounts of paid up insurance as outlined earlier;
- yearly amounts of protection and the yearly price of protection;
- a yearly rate of return on cash value insurance;
- any decrease in benefits as a result of policy loans;
- any increase in benefits as a result of dividends left with the insurance company to purchase additional coverage.

These data should extend ahead in time from the policy's nearest anniversary date to the policyholder's 75th birthday or for 30 years whichever is the longer. A summary of the above, as provided at the time of policy issue, should be attached.

- 9.13 The Committee also recommends that a further disclosure document be provided at policy renewal, or every 5 years, whichever is less, indicating:

- the beneficiary named;
- settlement options taken or available;
- dividend options taken or available;
- the current rate of interest on policy loans and on dividends left on deposit;
- any conditions which could materially change the individual's status as a policyholder, for example, expiry of accidental death or waiver of premium coverages.

## G. ENFORCEMENT

In structuring a mandatory system of disclosure, the Committee has also given consideration to *enforcement* provisions. Enforcement could be considered in several contexts:

- ensuring that all disclosure statements follow the mandated form;



- ensuring that disclosure statements are delivered and received by the consumer as required in the regulation; and
- ensuring that all financial information in disclosure statements is correct and not deceptive or fraudulent.

Direct enforcement of these conditions could be carried out by the Superintendent through the requirement for the filing, or at least the retention, of disclosure documents for inspection by the Department of Insurance.

However, the Committee favours another approach which would make disclosure regulations more self-enforcing.

- 9.14 The Committee recommends that the purchaser be given the right under insurance law to return his policy and obtain a full refund within fourteen months after the policy is delivered if the purchaser can show that mandatory disclosure requirements were not fully complied with.

This method would, in the Committee's opinion, reduce substantially the need for the Department of Insurance to commit resources to enforce the disclosure regulations.

## **H. ANNUAL SURVEY OF COST INDEX RATINGS**

The Committee recognizes the necessity of a survey of cost ratings for all policies sold in this Province, as essential to the use of Summary Cost Index numbers for cost comparison at the point of sale.

A survey of this type has been made available to consumers in Canada for the past 2 years in the form of the "Shoppers' Guide to Canadian Life Insurance Prices", sponsored by the Consumers' Association of Canada and published and edited by Mr. William E. McLeod. The method used in this survey to measure the cost of a life insurance policy is the interest-adjusted net cost index. A 1980 edition of this survey has not been published as a result of the withdrawal of CAC sponsorship of this particular publication.

The Committee concludes that there should be a continuing annual survey of life insurance prices in this Province, based on the measure of insurance cost used as a Summary Cost Index in the point of sale policy summary.

- 9.15 The Committee recommends that the Superintendent ensure that a comprehensive annual survey of life insurance prices is made available to the public in Ontario. The Committee recommends, however, that the onus to publish this annual survey be placed on the life insurance industry.

If the life insurance industry fails within a reasonable amount of time to demonstrate that it will take on the publication of this survey on an ongoing basis, the Committee recommends that the Superintendent

should consider such a production, with cost to be borne by the industry.

As the life insurance industry, through the CLIA, has already shown a commitment to the publication of a 1980 guide to life insurance prices, by supporting the efforts of the insurance publishers, Stone and Cox Ltd., in developing such a survey of prices, the Committee is encouraged that the life insurance industry will take on continuing responsibility for this publication.

The Committee would also like to see the continuing involvement of the Consumers' Association of Canada in the annual survey of life insurance prices to ensure that a consumer perspective is maintained in the publication. The Committee proposes to the Superintendent that he encourage the life insurance industry to seek CAC involvement in this survey, should such involvement be practical and acceptable to the CAC.

The efforts to date in producing an annual survey of life insurance prices have made use of the Interest-Adjusted Net Cost Index for comparison of similar policies. If the Committee's alternative recommendation for the Company Retention Index, as a point-of-sale Summary Cost Index, is adopted, then the annual survey of life insurance prices should make use of the Company Retention Index for comparing policies.

EXAMPLES OF "POINT OF SALE POLICY SUMMARY"  
FORMS AND "SUMMARY OF DETAILED POLICY  
INFORMATION" FORMS

POINT OF SALE POLICY SUMMARY  
FOR WHOLE LIFE AND ENDOWMENT INSURANCE

Company  
Type of Policy  
Name of Policy  
Amount Payable on Death  
Policyholder's Sex  
Policyholder's Age at Issue  
This policy pays/does not pay Dividends

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PREMIUMS

Yearly Premium for Standard Risk	\$
Supplementary Premiums:	
Waiver of Premium Rider	\$
Accidental Death Benefit	\$
Guaranteed Insurability Benefit	\$
Other	\$

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IMPORTANT TO COST COMPARISON

Your premium may not tell you all you need to know about the cost of this policy. To help you obtain a more complete measure of the cost of this policy, three indicators of cost are set out below. They are the Company Retention Index, the Average Cost of Protection, and the Average Rate of Return.

Each Cost Indicator gives you information about a different aspect of your policy. You can compare each Cost Indicator below with the similar Indicator for any other whole life or endowment policy to determine which policy is a better buy.

These Cost Indicators are explained on pages xx-xx of the Guide to Buying Life Insurance which you have received with this policy summary.

The Cost Indicators for this policy, if you keep this policy for:

	<u>Company</u> <u>Retention Index</u>	<u>Average Cost</u> <u>of Protection</u>	<u>Average</u> <u>Rate of Return</u>
5 years are			
10 years are			
20 years are			
30 years are			

A policy with a low Company Retention Index or a low Average Cost of Protection index is generally a better buy than a policy with a higher index number. A policy with a high Average Rate of Return is generally a better buy than a policy with a low Average Rate of Return. See the Guide to Buying Life Insurance for more information and examples of cost comparison.

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Signature of Agent

Date:



POINT-OF-SALE POLICY SUMMARY

FOR TERM INSURANCE AND TERM RIDERS

Company \_\_\_\_\_  
Type of Policy \_\_\_\_\_  
Name of Policy \_\_\_\_\_  
Initial Amount Payable on Death \_\_\_\_\_  
Length of Term \_\_\_\_\_  
Policyholder's Sex \_\_\_\_\_, Age at Issue \_\_\_\_\_

IMPORTANT

If you are buying term insurance for long-term needs, make sure your policy is guaranteed renewable through at least age 65.

This Policy is Renewable: Yes \_\_\_\_ No \_\_\_\_  
If yes, through what age? \_\_\_\_\_

This Policy is Convertible: Yes \_\_\_\_ No \_\_\_\_  
If yes, through what age? \_\_\_\_\_

PREMIUMS

Companies or Agents should enter in this space the annual premium and amount payable on death for representative policy years.

<u>Policy</u> <u>Years</u>	<u>Annual</u> <u>Premium</u>	<u>Amount</u> <u>Payable</u> <u>on Death</u>
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This policy pays/does not pay Dividends \_\_\_\_\_

SUPPLEMENTARY PREMIUMS

Waiver of Premium Rider	\$ _____
Accidental Death Benefit	\$ _____
Guaranteed Insurability Benefit	\$ _____
Other	\$ _____

IMPORTANT TO COST COMPARISON

Your premium may not tell you all you need to know about the cost of this policy. To help you obtain a more complete measure of the cost of this policy, two indicators of cost are set out below. They are the Company Retention Index and the Average Cost of Protection.

Each Cost Indicator gives you information about a different aspect of your policy. You can compare each Cost Indicator below with the similar Indicator for any other term insurance policy to determine which policy is a better buy.

These Cost Indicators are explained on pages xx-xx of the Guide to Buying Life Insurance which you have received with this policy summary. The Cost Indicators for this policy, if you keep this policy for:

	<u>Company</u> <u>Retention Index</u>	<u>Average Cost</u> <u>of Protection</u>	<u>Average</u> <u>Rate of Return*</u>
5 years are			
10 years are			
20 years are			
30 years are			

A policy with a low Company Retention Index or a low Average Cost of Protection index is generally a better buy than a policy with a higher index number. See the Guide to Buying Life Insurance for more information and examples of cost comparison.

\* For level premium term policies with a cash surrender value. See the Guide to Buying Life Insurance for more information on level premium term policies with cash values.

Signature of Agent \_\_\_\_\_

Date: \_\_\_\_\_

POINT OF SALE POLICY SUMMARY  
FOR NON-GUARANTEED WHOLE LIFE POLICIES

INCLUDING  
ADJUSTABLE BENEFIT POLICIES  
AND NEW MONEY POLICIES

Company \_\_\_\_\_  
Type of Policy \_\_\_\_\_  
Name of Policy \_\_\_\_\_  
Initial Amount Payable on Death \_\_\_\_\_  
Guaranteed Minimum Amount Payable on Death \_\_\_\_\_  
Policyholder's Sex \_\_\_\_\_  
Policyholder's Age at Issue \_\_\_\_\_  
This policy pays/does not pay Dividends \_\_\_\_\_

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Single Premium \$ \_\_\_\_\_ or Annual Premium \$ \_\_\_\_\_

Supplementary Premiums:

Waiver of Premiums	\$ _____
Accidental Death Benefit	\$ _____
Guaranteed Insurability Benefit	\$ _____

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- o Based on current market interest rates of \_\_\_\_%, the amount of insurance payable on your death is \$ \_\_\_\_\_.

This amount is guaranteed for \_\_\_\_ years.

IMPORTANT - In certain circumstances, the amount payable on death from this policy may be SMALLER in the future. Please read the following:

- o If, after \_\_\_\_ years, interest rates fall by:

(1%) %, you must pay \$ \_\_\_\_\_ extra in annual premium to keep the amount payable at death constant at \$ \_\_\_\_\_.  
(2%) %, you must pay \$ \_\_\_\_\_ extra in annual premium to keep the amount payable at death constant at \$ \_\_\_\_\_.  
(5%) %, you must pay \$ \_\_\_\_\_ extra in annual premium to keep the amount payable at death constant at \$ \_\_\_\_\_.

IMPORTANT - In certain circumstances, the amount payable upon death from this policy may be GREATER in the future. Please read the following:

- o If, after \_\_\_\_ years, interest rates rise by:

(1%) %, your insurance coverage will rise by \$ \_\_\_\_\_ to a total face amount of insurance of \$ \_\_\_\_\_.  
(2%) %, your insurance coverage will rise by \$ \_\_\_\_\_ to a total face amount of insurance of \$ \_\_\_\_\_.  
(5%) %, your insurance coverage will rise by \$ \_\_\_\_\_ to a total face amount of insurance of \$ \_\_\_\_\_.

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IMPORTANT TO COST COMPARISON

An appropriate method of cost comparison should be developed with assumptions clearly defined. Summary information should be printed here or on an appropriate attachment to the point of sale policy summary.

DETAILED POLICY INFORMATION  
FOR WHOLE LIFE AND ENDOWMENT INSURANCE

Policy Year	Age at Beginning of Year	Yearly Premium	Amount Payable on Death	Value of Paid Up Policy	Payable on Surrender	Illustrated Dividend(a)	Use of Dividends				Amount of Yearly Protection	Yearly Rate of Return
							Additions to Amount Payable on Death	Cumulative Additions to Amount Payable on Death	Additions to Amount Payable on Surrender	Cumulative Additions to Amount Payable on Surrender		
1	35	\$486	\$25,000	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0		
2	36	486	25,000	0	0	21	75	75	75	21		
3	37	486	25,000	1,125	375	27	75	150	150	53		
4	38	486	25,000	2,100	725	33	100	250	250	83		
5	39	486	25,000	3,025	1,075	43	125	375	375	130		
6	40	486	25,000	3,975	1,450	54	150	525	525	187		
7	41	486	25,000	4,850	1,825	65	175	700	700	258		
8	42	486	25,000	5,700	2,200	75	200	900	900	339		
9	43	486	25,000	6,550	2,600	86	225	1,125	1,125	431		
10	44	486	25,000	7,350	3,000	98	225	1,350	1,350	587		
11	45	486	25,000	8,225	3,450	110	250	1,600	1,600	704		
12	46	486	25,000	9,050	3,900	123	275	1,875	1,875	839		
13	47	486	25,000	9,875	4,375	137	300	2,175	2,175	990		
14	48	486	25,000	10,675	4,850	150	325	2,500	2,500	1,154		
15	49	486	25,000	11,425	5,325	164	350	2,850	2,850	1,333		
16	50	486	25,000	12,175	5,825	178	375	3,225	3,225	1,529		
17	51	486	25,000	12,900	6,325	192	375	3,600	3,600	1,846		
18	52	486	25,000	13,625	6,850	207	400	4,000	4,000	2,070		
19	53	486	25,000	14,325	7,375	222	425	4,425	4,425	2,311		
20	54	486	25,000	15,025	7,925	238	443	4,868	4,868	2,610		
21	55	486	25,000	15,525	8,375	252	459	5,327	5,327	2,925		
22	56	486	25,000	15,975	8,825	265	472	5,799	5,799	3,257		
23	57	486	25,000	16,425	9,275	278	484	6,283	6,283	3,609		
24	58	486	25,000	16,775	9,725	291	495	6,778	6,778	3,979		
25	59	486	25,000	17,250	10,175	304	506	7,284	7,284	4,370		
26	60	486	25,000	17,650	10,625	317	517	7,801	7,801	4,779		
27	61	486	25,000	18,025	11,075	330	527	8,328	8,328	5,208		
28	62	486	25,000	18,375	11,525	343	537	8,865	8,865	5,658		
29	63	486	25,000	18,725	11,975	356	546	9,411	9,411	6,125		
30	64	486	25,000	19,025	12,400	368	556	9,967	9,967	6,610		
31	65	486	25,000	19,300	12,825	381	563	10,530	10,530	7,113		
32	66	486	25,000	19,550	13,225	392	570	11,100	11,100	7,635		
33	67	486	25,000	19,800	13,625	404	577	11,677	11,677	8,171		
34	68	486	25,000	20,025	14,000	415	583	12,260	12,260	8,742		
35	69	486	25,000	20,225	14,375	426	589	12,849	12,849	9,242		
36	70	486	25,000	20,425	14,750	437	595	13,444	13,444	9,871		
37	71	486	25,000	20,625	15,100	447	600	14,044	14,044	10,477		
38	72	486	25,000	20,800	15,450	457	605	14,649	14,649	11,075		
39	73	486	25,000	20,975	15,800	467	609	15,258	15,258	11,697		
40	74	486	25,000	21,150	16,150	477	614	15,872	15,872	12,332		

(a) Neither estimates nor guarantees, but merely illustrations of the company's 1980 dividend scale.

SUMMARY OF DETAILED POLICY INFORMATION

FOR WHOLE LIFE AND ENDOWMENT INSURANCE

Company \_\_\_\_\_  
Type of Policy \_\_\_\_\_  
Name of Policy \_\_\_\_\_  
Amount Payable upon Death \_\_\_\_\_  
Policyholder's Sex \_\_\_\_\_, Age at Issue \_\_\_\_\_

PREMIUMS

	Annual	Monthly	Other
Yearly Premium for Standard Risk	\$		
Additional Yearly Premium for Substandard - Rated Risk	\$		
Supplementary Premiums:			
Waiver of Premium Rider	\$		
Accidental Death Benefit	\$		
Guaranteed Insurability Benefit	\$		
Other	\$		
Total	<u>\$</u>		

This policy pays/does not pay Dividends \_\_\_\_\_

IMPORTANT TO COST COMPARISON

Your premium may not tell you all you need to know about the cost of this policy. To help you obtain a more complete measure of the cost of this policy, three indicators of cost are set out below. They are the Company Retention Index, the Average Cost of Protection, and the Average Rate of Return.

Each Cost Indicator gives you information about a different aspect of your policy. You can compare each Cost Indicator below with the similar Indicator for any other whole life or endowment policy to determine which policy is a better buy.

These Cost Indicators are explained on pages xx-xx of the Guide to Buying Life Insurance which you have received with this policy summary.

The Cost Indicators for this policy, if you keep this policy for:

	<u>Company</u> <u>Retention Index</u>	<u>Average Cost</u> <u>of Protection</u>	<u>Average</u> <u>Rate of Return</u>
5 years are			
10 years are			
20 years are			
30 years are			

A policy with a low Company Retention Index or a low Average Cost of Protection index is generally a better buy than a policy with a higher index number. A policy with a high Average Rate of Return is generally a better buy than a policy with a low Average Rate of Return. See the Guide to Buying Life Insurance for more information and examples of cost comparison.

Signature of Agent \_\_\_\_\_

Date: \_\_\_\_\_



DETAILED POLICY INFORMATION  
FOR TERM INSURANCE AND TERM RIDERS

Policy Year	Age at Beginning of Year	Amount Yearly Premium	Value of Payable on Death	Paid Up Policy	Payable on Surrender	Illustrated Dividend(a)	Amount of Protection	Yearly Price	Yearly Rate of Return
1	35	\$ 89	\$25,000	0	0	0	\$25,000		
2	36	89	25,000	0	0	0	25,000		
3	37	89	25,000	0	0	0	25,000		
4	38	89	25,000	0	0	0	25,000		
5	39	89	25,000	0	0	0	25,000		
6	40	109	25,000	0	0	0	25,000		
7	41	109	25,000	0	0	0	25,000		
8	42	109	25,000	0	0	0	25,000		
9	43	109	25,000	0	0	0	25,000		
10	44	109	25,000	0	0	0	25,000		
11	45	167	25,000	0	0	0	25,000		
12	46	167	25,000	0	0	0	25,000		
13	47	167	25,000	0	0	0	25,000		
14	48	167	25,000	0	0	0	25,000		
15	49	167	25,000	0	0	0	25,000		
16	50	267	25,000	0	0	0	25,000		
17	51	267	25,000	0	0	0	25,000		
18	52	267	25,000	0	0	0	25,000		
19	53	267	25,000	0	0	0	25,000		
20	54	267	25,000	0	0	0	25,000		
21	55	445	25,000	0	0	0	25,000		
22	56	445	25,000	0	0	0	25,000		
23	57	445	25,000	0	0	0	25,000		
24	58	445	25,000	0	0	0	25,000		
25	59	445	25,000	0	0	0	25,000		
26	60	564	25,000	0	0	0	25,000		
27	61	564	25,000	0	0	0	25,000		
28	62	564	25,000	0	0	0	25,000		
29	63	564	25,000	0	0	0	25,000		
30	64	564	25,000	0	0	0	25,000		

(a) Neither estimates nor guarantees, but merely illustrations of the company's 1980 dividend scale.

SUMMARY OF DETAILED POLICY INFORMATION

FOR TERM INSURANCE AND TERM RIDERS

Company \_\_\_\_\_  
Type of Policy \_\_\_\_\_  
Name of Policy \_\_\_\_\_  
Initial Amount Payable at Death \_\_\_\_\_  
Length of Term \_\_\_\_\_  
Policyholder's Sex \_\_\_\_\_, Age at Issue \_\_\_\_\_

IMPORTANT

If you are buying term insurance for long-term needs, make sure your policy is guaranteed renewable through at least age 65.

This Policy is Renewable: Yes \_\_\_\_\_ No \_\_\_\_\_  
If yes, through what age: \_\_\_\_\_

This Policy is Convertible: Yes \_\_\_\_\_ No \_\_\_\_\_  
If yes, through what age: \_\_\_\_\_

FIRST YEAR PREMIUMS

		Annual	Monthly	Other
Premium for Standard Risk	\$			
Additional Premium for Substandard Rated Risk	\$			
Supplementary Premiums				
Waiver of Premium Rider	\$			
Accidental Death Benefit	\$			
Guaranteed Insurability Benefit	\$			
Other	\$			
Total	<u>\$</u>			

Basic Policy Premiums for later years are shown on the Detailed Policy Information Table

This policy pays/does not pay Dividends \_\_\_\_\_

IMPORTANT TO COST COMPARISON

Your premium may not tell you all you need to know about the cost of this policy. To help you obtain a more complete measure of the cost of this policy, two indicators of cost are set out below. They are the Company Retention Index and the Average Cost of Protection.

Each Cost Indicator gives you information about a different aspect of your policy. You can compare each Cost Indicator below with the similar Indicator for any other term insurance policy to determine which policy is a better buy.

These Cost Indicators are explained on pages xx-xx of the Guide to Buying Life Insurance which you have received with this policy summary. The Cost Indicators for this policy, if you keep this policy for:

	Company <u>Retention Index</u>	Average Cost <u>of Protection</u>	Average <u>Rate of Return*</u>
5 years are			
10 years are			
20 years are			
30 years are			

A policy with a low Company Retention Index or a low Average Cost of Protection index is generally a better buy than a policy with a higher index number. See the Guide to Buying Life Insurance for more information and examples of cost comparison.

\* For level premium term policies with cash surrender value. See the Guide to Buying Life Insurance for more information on level premium term policies with cash values.

Signature of Agent \_\_\_\_\_

Date: \_\_\_\_\_



**PART V**  
**THE MARKETING OF LIFE INSURANCE**





## CHAPTER 10

### Marketing Life Insurance and the Agency System

#### A. INTRODUCTION TO PART V AND CHAPTER 10

In the previous Part of this Report, the Committee commented on methods of informing and assisting the consumer through methods that fall under the generalized heading of *disclosure*. In this Part of the Report, the Committee concentrates on *marketing*, particularly on the development and training of agents to assist the consumer in his purchase of life insurance and annuities on an individual basis.

As the agent is traditionally an integral part of the life insurance system in its operations, most of the discussion in this Part focuses on the agent and on the agency system. The Committee has had the opportunity to hear about the role of the agent in the Ontario marketplace for life insurance from the Life Underwriters Association of Canada, from various insurance companies and from individual agents selling life insurance and annuity products. The Committee finds however, that the role of the agent has changed substantially in many areas of life insurance, such as group insurance and annuity sales. At the same time, other means of marketing without the services of an agent have developed. These changes warrant attention and also are the subject of some discussion in this Part.

Against this background and within the framework of marketing, this Chapter deals primarily with the agency system as it operates in this Province, with the objectives first:

- to look at the agency system as it has developed historically and as it is now recognized in Ontario in insurance law;
- to consider the characteristics and experience of the agency force in this Province, by reviewing the numbers and characteristics of licensed life insurance agents and the retention experience of agents in the life insurance industry in Canada; and
- to comment on the marketing approaches taken by insurance companies in various segments of the life insurance market;

and secondly, in the remainder of this Chapter:

- to consider single company representation and “brokers” in life insurance as matters pertinent to the Committee’s concern that buyers of life insurance be well served and informed by the life insurance industry.

Other aspects of the agency system, such as qualifications, training, conduct and compensation, will be subjects of subsequent Chapters.

## **B. THE DEVELOPMENT OF THE AGENCY SYSTEM AND RECOGNITION IN INSURANCE LAW**

### **1. Sales and Service in Life Insurance**

Life insurance has typically been sold by an agent appointed by the insurer. This system of distribution is known as the “agency system”.

The agency system for selling and servicing life insurance has had its major development on the North American continent. The main thrust began in the mid-nineteenth century in the eastern United States and by the end of that century was established throughout most parts of the United States and Canada.

Historically, the agency system was predicated primarily on the proposition that life insurance is not purchased voluntarily by the vast majority of people and hence “must be sold”. Life insurance companies turned to the agent to serve in the role of a skilled motivator in persuading people to recognize their future financial needs and to take action and protect their families in the event of their death.

Increasingly, it became obvious to insurance companies that the services of a good life insurance agent were also needed to explain the life insurance product to the consumer. The necessity that some knowledgeable person advise the consumer in his purchase arose out of the intangible and long-term nature of the life insurance product, as the consumer typically lacked the motivation to research and learn about a product that was bought infrequently. It also arose out of the sheer multiplicity and complexity of the many products and services offered by life insurance companies, which LUAC admits is “a challenge in itself for life agents to master”.

The Life Underwriters Association of Canada in its submission to the Committee, goes on to state that:

“The nature of the life insurance product is sufficiently complex in terms of actuarial and mathematical concepts that some degree of specialized knowledge is necessary to an adequate understanding”.

and that:

“Apart from the understanding of the technical product aspects, there remains the whole area of professional advice needed to help put together a life insurance program to best meet the individual’s financial needs and objectives. In this vital area, the purchaser must rely on the trustworthiness and professional competence of the agent rather than on disclosure.”

It is in such terms that LUAC describes the role of the agent in the current marketplace for life insurance.

In sum, LUAC states that the life agent is needed in a dual capacity to do what most people cannot or will not do for themselves, namely provide, first, the impetus for an individual to take action and, secondly, the technical knowledge and experience necessary for an individual to make wise decisions in arranging a life insurance program.

## **2. Recognition of the Agency System in Law**

With time, the agency system became recognized in insurance law through the licensing of agents. In order to carry on business as a life insurance agent in Ontario, The Insurance Act required that a person be licensed. By an “agent” is meant a

“person, who for compensation, . . . solicits insurance on behalf of an insurer or transmits . . . an application for or a policy of insurance to or from such insurer or offers or assumes to act in the negotiation of such insurance . . .”

The licensing of agents under The Insurance Act was structured to recognize the following two principles of the agency system, which govern its operation today in this Province:

1. The principal insurer-agent relationship. The insurer sponsors an applicant to act as its agent in the sale and servicing of its products. The Insurance Act requires that the applicant for the licence of an agent file with his application a certificate from an insurer certifying that he is appointed to act as its agent.
2. Single company representation. Under Section 342(13) of The Insurance Act, a life insurance agent can be licensed to act as an agent for no more than one insurer transacting life insurance. A consent in writing is required from the sponsoring insurer for insurance placed with any other insurer by reason of inability to negotiate insurance on behalf of the applicant with the insurer for which the agent is authorized to act.

These provisions of The Insurance Act will be a matter of Committee discussion in a later part of this Chapter. They in essence define the life insurance agent as an agent of the insurer.

In contrast to other areas of insurance, in life insurance, The Insurance Act does not provide for a licence for a person to act as an insurance broker. A broker for other than life insurance negotiates contracts of insurance and places risks with a licensed insurer or its agent, without the requirement of sponsorship by an insurer. Instead, the Act deems the broker as well as any agent not acting in regard to life insurance to be the agent of the insurer for whom he acts on a contract of insurance. In life insurance, only an individual sponsored by an insurer and licensed as an agent can negotiate and transmit an application for insurance to an insurer. Further-



more, as required by the single company representation provision, the agent can only transmit applications of insurance to his sponsoring insurer, unless consent to place a contract with another insurer is obtained in writing from the sponsor.

Regardless of the legislative requirements pertaining to sponsorship and single company representation, agents in some cases choose to work out of an agency that is a partnership or corporation, often independent of any financial or other support from a life insurance company. In such cases, each agent in the agency maintains sponsorship of an insurer, but often is recruited and trained by the agency. Agents in agencies which are largely independent of an insurance company are sometimes referred to as "brokers". This usage of the term is not, however, recognized in The Insurance Act.

Given this brief overview of the development of the agency system, and its current form as set out in The Insurance Act, discussion now turns to the topic of the characteristics and experience of the agency force in this Province, followed by review of the retention experience of agents in the industry.

## C. NUMBERS AND CHARACTERISTICS OF LICENSED LIFE INSURANCE AGENTS

### 1. Data from the Department of Insurance

Since 1970, the Ontario Department of Insurance has reported the following number of life licences issued to agents:

1970	13,999
1971	14,685
1972	14,586
1973	14,206
1974	14,224
1975	14,573
1976	14,731
1977	15,224

For the year starting April 1, 1978 and ended March 31, 1979, the Department of Insurance reports the following pattern of licensing:

Renewals issued April 1, 1978	<u>11,560</u>
New licences issued over the year	2,750
Net licences terminated over the year <sup>1</sup>	2,360
Renewals issued April 1, 1979	<u>11,950</u>

This pattern indicates that the number of renewal and new licences

1. The gross figures were 3,490 terminations of which 1,130 were transfers.

held over the licensing year 1978 was 14,310, significantly below the numbers reported for the previous year. Of this total about 19 percent were newly licensed agents. This compares, in the previous three years, with on average about 17 percent of agents estimated by LUAC as newly licensed, or about 2,550 per year.

In proportion to the total number of licensed agents in that year, terminations represented about 16 percent. This proportion is again similar to the 15 percent net annual loss of life agents estimated by LUAC for the previous 3 years.

Data are also available indicating 1,130 transfers of licensed agents to other life companies. This represents about 8 percent of licensed agents. Combining this percentage with the percentage of agents who are newly licensed it is possible to estimate that more than one in four licensed agents employed by life insurance companies in 1978 were in their first year of selling for that company.

Taking the average number of agents licensed in Ontario over the last four years as approximately 14,700, the number of agents per 1,000 population has averaged at about 1.7.

## **2. Industry Data on Full-Time Life Agents**

The Committee has found that a number of estimates exist of the number of full-time agents licensed to sell life insurance. With respect to the numbers provided by the Superintendent of Insurance as detailed above, it appears from these data that more than 14,000 persons are licensed annually as life insurance agents. The Superintendent has commented on these numbers as follows:

“With respect to some 14,700 licensed agents, each and every one has filed with us a statement that they are engaged in no other occupation other than that of a life insurance agent. In addition, their sponsorship for licences are verified and certified by their sponsoring insurer.”

However, LUAC in its presentation to the Committee made the claim that, even though more than 14,000 life licences are issued annually in Ontario, the actual number of active full-time agents in Ontario was probably closer to 7,800. Similarly, CLIA reported from a survey of its member companies,<sup>1</sup> that as of December 1977, there were 7,514 active full-time agents and managers working in Ontario for CLIA member companies.

LUAC has attempted to reconcile industry figures for licensed agents as compared with the figures issued by the Department of Insurance for

1. CLIA member companies write 99 percent of the life insurance and annuity business in Canada.

1977. Its summary presentation is provided here as the Committee is unable to obtain any more complete data. Most significant is the lack of data from the Department of Insurance to indicate how many life agents are also licensed to sell general insurance and hence reported not to be included in the life industry figures provided to the Committee.

**ANALYSIS OF LIFE AGENT  
LICENCES IN ONTARIO—1977**

Type of Agent	Number of Licences
CLIA member company full-time agents	7,514
Agents leaving the business during the year	2,225
Mutual fund	750
Non-Residents	500
Retired, disabled, semi-retired	700
Fraternal companies (assumed only)	300
General agents who have a life licence largely for convenience (estimated as a residual figure)	3,235
Total life licences	15,224

NOTE: The above figures are rough approximations based on incomplete data and are intended only to assist in the current efforts to develop an accurate analysis of the licensing of life agents in Ontario.

Source: Life Underwriters Association of Canada

While these data must be used with caution, it is apparent that a significant proportion of life insurance agents may not in practice be devoting their full time to the sale of life insurance. It appears however that many of these are general agents so that their occupation may not be in conflict with their role as life insurance agents as presently set out in the Act and in regulations.

### 3. Observations

The Committee is not content with the precision of the data available from the Office of the Superintendent on persons licensed as life insurance agents. In particular, it would be useful to a better knowledge of the industry to know how many agents selling life insurance are also general agents. The Committee will comment in a later Chapter on its views regarding licensing of agents. The Committee wishes here to draw the Superintendent's attention to the Committee's expectation that in the coming year, or at most two, efforts should be made by the Department of Insurance to improve the registration system for agents to provide better information in a form that sets out the more significant distinctions in types of agents that are found in the life insurance marketplace.

## **D. RETENTION OF LIFE INSURANCE AGENTS AND AGENT EXPERIENCE**

### **1. Current Retention Experience**

A further topic brought to the Committee's attention is that of retention of life insurance agents in the industry and the effect of turnover rates on the experience of the agency force in this Province.

Information provided by the Office of the Superintendent indicates that over the last ten years, more than 2,500 new agents have been licensed each year in Ontario. However the total number of life insurance agents has remained relatively level, with the numbers being approximately 14,000 to 15,000 for this period. It is therefore apparent that the turnover of life agents in this Province has been roughly equivalent to the number of agents newly licensed each year. This conclusion was demonstrated by the data shown earlier for the 1978 licensing year: in that year 19 percent of licensed agents were newly licensed and of those renewing or newly receiving licences over the year, 16 percent terminated their licence in that year.

According to the LIMRA Manpower and Production Surveys, the overall turnover rate for ordinary career agents in Canada for 20 companies surveyed has remained at 26 percent, for the calendar years 1975, 1976, 1977. The LIMRA surveys for Canada indicate a somewhat higher turnover rate than is indicated by the 1978 data for Ontario from the Office of the Superintendent. It should be noted that, in addition to the possibility of differences in agent turnover rates between Ontario and Canada, the agent population in the LIMRA survey likely differs from the total population of licensed agents, in that the LIMRA data are based on "ordinary career agents" and a survey of only 20 companies.

The LIMRA surveys also show that the four-year retention of agents for the years 1975, 1976 and 1977 has been 15%, 17% and 15% respectively. This means that of the agents who are put on contract, only 15% to 17% of them will still be on contract four years later. Much of the drop out that gives rise to these statistics occurs in the first two years of licensing. In 1977, 29 percent of agents in their first year of contract terminated their contract. Of those entering the second year, 50 percent terminated in that year. Of those entering the third and fourth years 35 percent and 23 percent respectively terminated. For the fifth year and over only about 10 percent were terminating.

It should however be noted that the termination rates reported in the LIMRA surveys, particularly in the first and second years, have improved steadily since 1971 when 40 percent of agents dropped out in the first year and 58 percent in the second year of contract. Noteworthy also are industry comments that there exist dramatic differences in retention of agents from one company to another.



Based on either the LIMRA surveys or on the data from the Office of the Superintendent in Ontario, it is apparent that the life insurance industry experiences a relatively significant rate of licence terminations.

The consequences of this include:

- The likelihood that a large proportion of policyholders may be “orphaned”, that is, left without agent service on an ongoing basis.
- The need for life insurers to recruit and train annually a significant number of new agents with the result that the costs of such recruitment and training must be borne by insurers and ultimately policyholders. The cost to the policyholder may be in the way of higher premiums but may also be reflected in the undefined cost of inexperienced advice and service.
- The possibility that agent turnover may contribute to early policy cancellations and high lapse rates, in that many sales are made each year by new and inexperienced agents recruited annually to balance the turnover rate.

The matters of “orphaned” policyholders and lapsed policies are of particular concern to the Committee. The significance of these matters, although they cannot be measured by the Committee, cannot be ignored. They are among the factors that have led the Committee to recommend a mandatory system of disclosure both at the time of policy sale and issue and on an ongoing basis.

In regard to the length of experience of agents selling life insurance in Canada, the LIMRA surveys indicate that in 1977, for ordinary career agents, 27% of agents retaining their licence were in their first year of service, 12% in their second, 8% in their third year, 5% in their fourth and 48% were licensed for five years or more. These data show that more than half of the ordinary career agents surveyed have been in the industry in Canada for less than five years. Similarly, LUAC data on its membership as of April 25, 1978 show that 47 percent of members had been members for 5 years or less and that of some 14,800 new members recruited over the preceding five years, about half were retained.

The current retention rates are a matter of industry concern because of the extensive costs involved in new agent recruiting. Consumer concern also arises in that a poor retention rate and a high proportion of new recruits in the agency force may combine to produce on average a poorer level of service than is desirable.

Industry efforts to improve agent retention rates tend to centre around the course of action advocated by Mr. R. L. Kayler, General Counsel of LUAC, in the following comment:

“... important to agent retention is an effective program of training,

education, and supervision during the first two or three years in the business".<sup>1</sup>

## **2. Observations**

Although the Committee is informed that the agent retention experience in the life insurance industry in Canada is more favourable than in the United States, the Committee views the turnover rate of life insurance agents to be a significant cost factor for the industry and ultimately for the policyholder. The Committee believes that policyholders ultimately bear this cost as well as the commission cost which arises out of the premise that life insurance has to be sold. It would seem that the difficulty of recruiting and retaining agents may in part be linked to the difficulty of selling life insurance products; in part to the consumer's possible perception of the agent as biased or only "after a sale"; and in part to the agency and commission compensation system which makes it difficult for many new agents to stay in the field unless they succeed quickly in sales. The Committee will be commenting on all these areas in later sections of this Part on Marketing.

Discussion now turns to marketing in various sectors of the insurance market.

## **E. MARKETING IN VARIOUS SECTORS OF THE LIFE INSURANCE MARKET**

### **1. Diversity of Marketing Approaches**

The Committee is concerned that the legislative framework which pertains to the agency system and other methods of selling life insurance should recognize and respond if necessary to the various approaches taken by insurers and agents in this Province in selling life insurance and annuity products.

In general, the Committee found in its overview of the life insurance industry in Chapter Two, that many life insurers concentrate their business in selected market segments. These segments are sometimes defined around a type of product, such as term insurance; other times they are defined around a broad category of business, such as group insurance; and in many cases the market segments are defined by income level or other characteristics of the policyholder. In all cases, the marketing approach taken by the insurer varies to suit the needs of each market segment. Consequently, the emphasis placed on the role of the agent and the nature of that role tend also to vary to suit each market segment.

The Committee turns to a brief review of various marketing approaches outlined to the Committee during its investigations. The following discussion will deal in turn with marketing approaches in:

1. Correspondence 10/10/78 from R. L. Kayler to M. A. Thompson, Superintendent of Insurance.

- individual life insurance
- group life insurance and pensions
- individual annuities

and also with the marketing approach of direct selling.

## **2. Individual Life Insurance**

Most insurance companies and agents appear to distinguish in their sales methods between high income earners and the general market. Agents selling to high income earners are required to have knowledge of estate planning, business insurance needs, taxation and law in order to provide their clients with a wide range of services. It is common for agents with this breadth of knowledge to refer to themselves as financial consultants.

The Committee has found that a good number of companies concentrate on selling to high income earners and structure their training and compensation programs to develop agents with the skills needed for this market. Many companies also design special products and advertising for this market. For example, variable contracts and policies with non-guaranteed benefits are typically sold to this market segment.

Fewer companies in Canada appear to concentrate specifically on low and middle income earners. For example, the practice common in the United States of selling small policies on a weekly or monthly collection system, referred to as debit or industrial insurance, is much less common in Canada and seems to be disappearing entirely. However, of the companies appearing before the Committee, the Mutual Life Assurance Company and the London Life Insurance Company indicated their focus on the lower and middle income market, with London Life, for example, structured into two sales divisions, a general sales division concentrating on people earning more than \$20,000 per year and a district sales division concentrating on sales to smaller income groups in defined geographical districts.

The apparent segmenting or “targeting” of the individual life insurance market by life insurance companies along the lines of income level or other characteristics of the prospective insured, is in the Committee’s view a natural process given that life insurance is sold in a voluntary market. It points out, however, that the role of an agent is not identical in all market situations. It suggests also that regulations pertaining to the agent and his activities might need to recognize the variety of market situations which the agent serves.

## **3. Group Life Insurance and Pensions**

The nature of sales and service in the group market is quite different from that found in the individual market for the following reasons:

- sales are made to employers, associations, unions, associations of

employers or to lending institutions, in the case of creditor's life insurance—these buyers being regarded on the whole as more sophisticated than the individual buyer;

- the market is regarded as highly competitive and well saturated, requiring a specialized sales effort; and
- buyers often do not need to be “sold on the product”, for example through emotional appeals, because they are generally already committed to providing a package of insurance and pension benefits.

The marketing force in the group life insurance and pension segment of the market is therefore developed typically as a separate field force. Because of the highly technical products and keen competition in the group insurance market, extensive agent training is required, covering product, benefit plan design, legislation, pricing, sales and communication skills.

In the case of small to medium size groups, agents engaged primarily in the sale of individual policies may also participate in group sales. They generally rely on technical support from the group division of their sponsoring insurer. These agents may, in some cases, be general agents with life insurance licences. They have the advantage of providing personal service to small businessmen or groups in their community.

Also engaged in the sale of group benefits are agents who call themselves consultants because of their expertise in the field of employee benefits. These agents may place business through companies other than their licence sponsoring company. Consultants may also be persons not engaged in selling group benefits, but engaged in employee benefit plan design, in providing actuarial services or in providing pricing recommendations. A further category of participant in the group benefits market is the “broker”, whose service is to obtain quotations from insurance companies to seek the lowest price for the group benefits package. The Committee has found that in some cases the agent, the consultant and the “broker” are combined in one person or in one agency, with each role exercised separately in some sales situations or in combination with the other roles in other situations.

Again, the Committee finds significant variety in the role of the agent, not only in comparison to life insurance, but within the group insurance and pension business itself.

#### **4. Individual Annuities**

Sales of individual annuity products are typically carried out by a company's general sales force, with perhaps somewhat greater emphasis on the high income market segment. The market for annuities has, however, broadened with the growth in sales of registered retirement savings plans.

Because annuity payments are tied into current money market conditions, and are subject to change at any time, the need to price shop in this



market has been recognized and taken advantage of by annuity “quotation specialists”. These quotation specialists obtain annuity prices or quotes on monthly payments from life insurance as a service sold to other agents or provided to their own customers. In many cases quotation specialists are also agents and earn commission income through sales of annuities while providing their quotation service free of charge.

As some life insurance companies do not engage heavily in the annuity market, they readily provide letters of consent or general approval of their agents to place annuity business with other life insurers. In general, it is the common practice for insurance companies to permit their agents to place single premium annuity business elsewhere when price differences arise.

In sum, the Committee sees within the current annuity market a much greater role played by agents in shopping for consumers, than is evident in the individual life insurance market. This process of shopping around occurs in spite of the single sponsor-agent relationship established in The Insurance Act.

## **5. Direct Selling**

Direct selling, as practised by a number of life insurance companies in Canada, generally means that a member of the public is invited to fill out a coupon or application form in an advertisement or mailed solicitation and mail it directly to the insurer. The advertising usually features as an advantage the fact that “no agent will call”. The costs of acquiring business are paid to the advertising media rather than to licensed agents.

The Committee has found the extent of selling of life insurance by mail or advertising to be limited. For example, Eaton/Bay Financial Services in its appearance before the Committee, indicated that only part of its sales comes from direct mail and advertising methods; a further significant part comes from customers visiting that company’s financial centres and dealing with salaried, but licensed service personnel.

The Committee further found that the amounts of life insurance sold and the conditions of eligibility for coverage under direct mail and advertising are generally limited for underwriting reasons, hence limiting the market scope of direct sales.

With this background review of the agency system and the differing marketing approaches of life insurance companies, the Committee turns to consideration of single company representation and consideration of brokers in life insurance.

## **F. SINGLE COMPANY REPRESENTATION AND ALTERNATIVES TO THIS SYSTEM**

### **1. Existing Law**

Single company representation occurs where an agent is restricted,

either by law, or by contract, to acting as agent for only one insurer. In Ontario, Section 342(13) of The Insurance Act provides that a life agent shall be licensed to act as agent for only one insurer. However, where the agent is unable to negotiate life insurance on behalf of the applicant with the insurer represented, the agent may obtain written consent from his sponsoring insurer to place the insurance with another insurer. The written consent must be filed with the Superintendent of Insurance.

The law in Nova Scotia and Newfoundland is the same as in Ontario. Of the other seven provinces Quebec has never had the single company provision, two Provinces have repealed the provision and four have suspended it for all life agents who have been licensed for at least two years. None of the states in the United States have a single company representation law, although some restrict agents in their first years of business, and neither has Australia, nor Great Britain. However, none of these Provinces or countries restrict a company from contracting an agent to the single company representation system. The Committee contacted the Superintendents of Insurance in the Provinces of Saskatchewan, Alberta and Manitoba regarding recent changes in their insurance law with respect to single company representation. The date and nature of the amendments to their insurance statutes are as follows:

*Saskatchewan*, October 16, 1974:

The requirement for single company representation for agents selling life insurance was removed for individuals who have been licensed as an agent for life insurance for a period of at least two years.

*Alberta*, November 25, 1977:

The requirement for single company representation for agents selling life insurance was removed for persons who have held a certificate of authority to write life insurance for at least two years.

*Manitoba*, June 15, 1979:

The requirement for single company representation for agents selling life insurance was removed for agents who have held a licence for the transaction of life insurance as the authorized agent of the same insurer for at least 2 continuous years.

In all three Provinces contacted, the amendments noted above do not grant any statutory privilege, but rather remove a prohibition. The life agent's actions continue to be governed by his contract with his sponsoring insurer rather than by legislation.

Following are comments from the Superintendents of the Provinces polled regarding experience under the amended provisions on single company representation.

— Saskatchewan, E. M. Sanderson: "The change has worked well in this Province."

- Alberta, J. O. Darwish: “It has now been almost two years since the amendment was made and I am not aware of one complaint that can be directly related to this change. I cannot prove any positive results, but I assume that consumers are getting a wider choice of policies. Obviously, from those comments, there has not been any drastic change in the way business is conducted in Alberta.”
- Manitoba, Emily Stamp: “Before proceeding with the removal of this requirement, Manitoba canvassed those Provinces as to their experience after removal. As all reported that no significant problems had arisen, there appeared no reason why Manitoba should not follow suit.”

## 2. Practice in Ontario

The LUAC presentation to the Committee with respect to the existing law on single company representation states as follows:

“The existing law was instituted some fifty years ago and worked well during the period when the life insurance business was very simple, types of policies were limited, and group insurance and employee benefits were almost unknown. But when the range of policies and their uses increased, the so-called “single case agreement” began to be used with greater frequency. By common consent, industry leaders and the various Superintendents of Insurance proceeded to permit an increasingly liberal interpretation to the words “unable to negotiate”. The original legislators probably intended that the single case agreement would only apply where the sponsoring insurer could not or would not issue the policy applied for. In recent years, this interpretation has been greatly liberalized. . . .”

The Life Underwriters Association of Canada, in its “Principles of Life Agency Operations”, specifies six cases where the interpretation of the existing law has been liberalized so that a life agent can be called upon to place business with another insurer:

- group business,
- rated policies,
- single premium annuities,
- substantial difference in premium rate or value,
- special client relationship,
- insurer does not issue the type of policy desired.

All of these cases result from a desire to offer the best service possible to the client.

In practice, it appears that a number of agents do not obtain the letter of consent, or else do not file it with the Superintendent. It is said that the filing of consent is virtually ignored with respect to group insurance. LUAC states that “thus the Superintendent is placed in the unfair position of administer-

ing a law which is no longer properly enforceable in the light of the greatly changed marketing conditions that prevail in the life insurance business''.

However, in the 1976 joint LIMRA-LUAC Survey of Agency Opinion, 74% of English-speaking ordinary agents reported placing 100% of their business with their primary company. The following table provides more information:

**TABLE 1**  
**PLACEMENT OF POLICIES WITH THE PRIMARY COMPANY**

<b>Percent of All Policies Placed With Primary company</b>	<b>Ordinary Agents</b>	<b>Combination Agents</b>	<b>General Insurance Agents</b>
<i>English Speaking</i>			
100%	74%	83%	78%
80% to 99%	22	15	18
Less than 80%	4	2	4
	<u>100%</u>	<u>100%</u>	<u>100%</u>
<i>French Speaking</i>			
100%	88%	93%	69%
80% to 99%	9	6	23
Less than 80%	3	1	8
	<u>100%</u>	<u>100%</u>	<u>100%</u>

Source: LIMRA, Survey of Agency Opinion, 1976.

Different opinions exist in the life insurance industry in regard to the appropriateness of a mandatory single company representation requirement in this Province. Discussion of these different points of view follows.

### **3. Objectives and Advantages of Single Company Representation**

In consideration of the best interests of consumers today, the following major advantages have been stated by those life insurance companies wishing to retain the use of single company representation.

1. It provides consumer satisfaction as evidence by lower lapse rates. This is achieved by providing:
  - advice from well-trained competent life agents selling products from a company with a good reputation
  - advice on changing of coverage caused by changes in personal situation
  - various consumer services such as Estate Planning, which require a detailed knowledge of the company's products
  - continued service for orphan policyholders



- a smaller likelihood of increased premiums caused by increased lapse rates.
- 2. It reduces agent turnover, resulting in a higher level of competent advice for the consumer. Reduced agent turnover is caused by:
  - satisfaction of agents with company
  - ability of company to choose best agents to represent the single company
  - giving technical support to the agent, in the form of literature, administrative help and, for the first few years, financial support.

The reduced agent turnover rate is said to be evidenced by comparing Canadian agent retention, where single company representation has been required in most Provinces until recently, of 17% over four years and U.S. agent retention, where there is no single company representation, of 12-13%, both for the period 1974-1977.

- 3. It permits the companies to provide agents with thorough basic training, good supervision, and ongoing technical assistance, support and training, which could not be done if the agent was free to represent any company. The training and ongoing education result in agents who are skilled in their companies' own policy portfolio and systems, which can be complex and very different from other companies. It can help the company to reduce premium prices, by removing certain underwriting practices, as the company feels it can rely on its own trained agents.

It has been stressed by those companies wishing to retain a single company system that the three points noted above are interrelated, for better training and selection leads to lower agent turnover, and a lower agent turnover, combined with better training, helps create consumer satisfaction.

Other arguments in favour of single company representation contend that:

- If agents are not tied to a company, they will be able to search for the highest commission, paying more regard to that factor than the suitability of the policy for the client. That is, the agent being permitted to "shop", may end up shopping for the highest commission only. The fear is also expressed that agents freed to place business where they like would gravitate to the high premium, upper income buyers, leaving the other income groups unserved.
- Insurance companies are better able to take full responsibility for the action of their agents under a system of single company representation. Single company representation permits the company to control the actions of the agent through direct responsibility for his actions, and through close supervision. For example, it permits companies to monitor more effectively the persistency of each agent's business and institute programs to improve persistency.

- Single company representation permits the insurer to “target” his market by training agents and providing directions and policies which are aimed at a certain segment of the population. This ensures better service to the “target” market.
- Single company representation does not restrict a consumer from shopping around. There is no reason why a consumer should not visit a number of agents to try to compare policies. In fact, with the number of complex policies offered by different companies, no one agent could have a detailed knowledge of them all. Single company representation would ensure that each agent approached would, at the least, accurately explain his sponsoring company’s product range.
- Single company representation facilitates insurer control over the agent and, hence, greater insurer reliance upon the accuracy and completeness of underwriting information submitted by the agent, and thus, less reliance on outside sources of underwriting information.
- Single company representation avoids the critical problem when an agent places business with several companies of deciding which company is responsible for the conduct of the agent: the sponsoring company or the one which received the business.

#### **4. Disadvantages of Single Company Representation**

On the other side of the question, it has been argued that there are numerous disadvantages to the consumer under a mandatory system of single company representation. Arguments made to the Committee include:

- As an agent is tied to one company, he has little or no knowledge of other companies’ products, and is not likely to be able to recommend a policy perhaps more suited to the needs of the client. This limits “shopping” for the best policy.

Even if an agent does not have a detailed knowledge of all products available in the marketplace to assist the consumer in shopping around, he is able to obtain more information if requested or required by the consumer. He is also said to be better able than the consumer to interpret this information in comparing policies. It is argued that the agent will not consistently go to this effort if he is unable to place business with the insurer offering the best policy.

- By being tied to one company, agents lack interest in comparative prices of policies. This situation is said to be detrimental to the client.
- The letter of consent system, when a client genuinely cannot be serviced by the agent’s company, is awkward to work with. Also, letters of consent are unnecessary when the agent works for a company that freely provides them.

- A breakdown of single company representation is reported, evidenced by the lack of filing of the letter of consent and the incidence of “underground” sales, whereby agents pass business to agents with other companies in order to place the business where the client desires. This places the Superintendent of Insurance in the position of having to enforce a policy that is now being ignored.
- Single company representation is said to be particularly unsuited to group life and pension insurance where groups shop for the best policy and terms. These purchasers prefer not to deal directly with each insurer, but prefer to rely on one person to carry out the negotiations with various insurers. While many businesses tend to have advisors other than agents for this purpose, smaller businesses in particular may rely on an agent to negotiate with insurers.

Proponents of removing single company representation indicate that changed market conditions, leading to the proliferation of various policies, require an agent to be able to sell more than those products offered by a single insurer, as these may not be suitable for an individual client.

## **5. Contracts Binding an Agent to a Single Insurer**

It has been stated before the Committee that the advantages of single company representation can be achieved through contractual arrangements between agents and insurers rather than necessitating the requirement for single company representation in law. That is, if a particular insurer wishes to operate on the basis of a completely captive agency force and to forbid its agents to place business with another insurer in any or in certain circumstances, then it could be left open to such an insurer to enter into contractual arrangements with its agents on that basis.

The difficulty with this arrangement, as it has proven to be with single company representation given its current lax enforcement, is that it can become difficult for insurers to control their single-company contracts as the placing of business with another company might not be reported, either by the agent or by the company receiving business. To overcome this difficulty, it is proposed by LUAC that:

“Where a life agent wishes to negotiate a life insurance or annuity contract with an insurer other than the sponsoring insurer, the agent should make a written request to the sponsoring insurer which should be given consent in accordance with the terms of the agency contract and any industry guidelines which are applicable, but there should be no requirement for filing such consent with the Superintendent of Insurance.”

It is, nevertheless, argued by some that, if single company representation were left to purely contractual arrangements, in time this would lead to an erosion of the agency system and of single-company sponsorship and



their advantages, because the problem of control of agents placing business with other companies would never be satisfactorily resolved. The result in the long term would be a lesser commitment of insurers toward training agents and supervising their conduct, this decrease in commitment being detrimental to the consumer.

## **6. Multi-Company Representation and Brokers in Life Insurance**

In contrast to either mandatory single company representation or voluntary single company agent-insurer contracts, it has been proposed to the Committee by the Consumers' Association of Canada that "life insurance companies should be forced to give up control over agents, including the prohibition of single company contracts between the company and its agents". In other words, it has been suggested that multi-company representation, which allows agents to place business through a choice of insurers be adopted as the system of marketing of life insurance in this Province.

In favour of this system, it is argued that the consumer will be better served by a "general" agent who is free to place insurance with whatever insurer offers a suitable and suitably priced product. It is further argued that a contract or law binding an agent to an insurer is not necessary from the insurers' viewpoint, as day-to-day relationships will bind an agent to several prime insurers or to one single insurer, for example through pride and a desire to serve that company. Other factors that bind agents to insurers include:

- training;
- compensation structure including financial support and bonuses for level of business;
- technical support and information services.

With removal of single company representation, responsibility for the acts of an agent could, by law, be applied to any life insurer who accepts an application from a life agent in the same manner as this responsibility is inherent in a life insurer's sponsorship of the life agent's licence.

Alternatively, multi-company representation could be achieved by substituting the concept of "*brokers*" for that of agents or "general agents" in the sale of life insurance. Brokers would not be sponsored by any one insurer and could deal with any or all insurers. They likely would be allowed to receive fees from the public as well as commissions from insurers. As noted at the beginning of this chapter, brokers as defined in the Act, are not allowed to sell life insurance in this Province, although the term "broker" is loosely used to describe some agents who, aside from the commission payments they receive, operate largely independently of any training or financial support from insurers. These "brokers" are still required to operate under the single company representation and company sponsorship requirements of the Act.



A partial step toward the introduction of brokers into the sale of life insurance was suggested by the Ministry of Consumer and Commercial Relations which, in April 1978, issued proposals for amendment of Part XIV of The Insurance Act. The proposals called for two classes of intermediaries in life insurance: life insurance agents and brokers. A life agent would be tied to one insurer in a single company representation relationship. The agent would be restricted to commissions from his sponsoring insurer and would be restricted to placing a case with another insurer only through his sponsor and only if the sponsor does not issue the plan of insurance required. Brokers on the other hand would have no restrictions and could deal with any or all life insurers. They could receive fees from the public and commissions from insurers.

This proposal parallels a similar proposal for changes to Part XIV of the Act with respect to agents and brokers selling property-casualty insurance and automobile insurance. In regard to brokers, a proposal prepared by the Independent Insurance Agents and Brokers of Ontario and the Toronto Insurance Conference calls for the government to set up a self-regulatory body called the Registered Insurance Brokers of Ontario. This body is to be operated by an eleven-member council, with four representatives selected by I.I.A.B.O., four by T.I.C. and three public interest representatives. It is proposed that R.I.B.O. would assume responsibility for defining and enforcing the standards of qualifications and conduct for licensed brokers. Furthermore, R.I.B.O. is intended to provide guarantees to the public that will protect against inadequacies in insurance coverage caused by errors or omissions and by defalcations.

LUAC has strongly opposed this proposal in a submission to the then Minister, Larry Grossman, Q.C., M.P.P. and before the Committee. LUAC has said the proposal would:

“inevitably lead to a polarization of the two classes of intermediaries with the agents being downgraded as second class citizens”,

as they would be cast as biased in contrast to brokers who would not be tied to any one company. LUAC argues that professional standards would suffer among agents as it would become more difficult to attract high quality candidates. LUAC also argues that the agency force would deteriorate not only in quality, but also in numbers, with no guarantee that the vacuum would be filled by brokers. Hence, LUAC recommends that:

“For the distribution of life insurance, there should be only one class of licensed intermediaries to be known as life insurance agents”.

## **G. THE COMMITTEE'S OBSERVATIONS ON THE PRINCIPLES OF THE AGENCY SYSTEM**

Two key principles of the agency system are at present defined under

The Insurance Act. The first is the principal insurer-agent relationship wherein an insurer must sponsor an applicant to act as an agent in selling and servicing his products. The second is the principle of single company representation.

These two long-standing principles govern the marketing of life insurance in the Province. The Committee has undertaken to evaluate and comment on these two principles to ensure that the legislative framework which pertains to the agency system is responsive to consumer needs and recognizes, when appropriate, the various approaches taken by insurers and agents in this Province in selling life insurance and annuity products.

The Committee has considered the current legislative framework and a range of alternatives to that framework, as will be set out below, in order to evaluate which form, if any, of legislative definition is needed to reflect the interrelationship that should exist between the insurer and the sales intermediary in regard to their respective duties to the public. The range of proposals considered by the Committee, together with the Committee's conclusions, follow immediately after the listing of alternative proposals.

## **1. Approaches to Defining The Insurer-Sales Intermediary Relationship**

Alternative approaches to defining the insurer-sales intermediary relationship, as considered by the Committee, include the following.

1. Retain in The Insurance Act the current provision for agent sponsorship and for single company representation. The latter reads as follows:

342(13) "No life insurance agent shall be licensed to act as agent for more than one insurer transacting life insurance, and the name of such insurer shall be specified in the licence, and no such agent shall represent himself to the public by advertisement or otherwise as the agent of more than one such insurer, but where such an agent is unable to negotiate insurance on behalf of an applicant for insurance with the insurer for which he is the authorized agent, such agent has the right to procure such insurance from another insurer if such other insurer obtains in each case the consent in writing of the insurer for which such agent is the authorized agent, and files a copy of such consent with the Superintendent."

Recommend stricter enforcement of single company representation, with respect to issuing and filing letters of consent.

2. Retain in The Insurance Act the provision for agent sponsorship and for single company representation, the latter amended to provide for specified exceptions as currently defined in the LUAC "Principles of Life Agency Operations". The Principles state that letters of consent to place

business with another company may be granted or accepted in the case of:

- group insurance
- rated policies
- single premium annuities
- substantial difference in premium rate or value
- special client relationship with another insurer
- sponsoring insurer will not issue the policy desired.

The amendment might permit each company to have the right to decide under which of the six exceptions, if any, it will allow its agents to request letters of consent.

3. Remove from The Insurance Act Section 342(13) pertaining to single company representation, but retain the agent sponsorship provision and permit life insurance companies to continue using the single company system by means of their contractual relationships with their own agents.

Redefine the responsibility of the insurer as follows, as recommended by LUAC:

“The same degree of responsibility for the acts of its agent inherent in a life insurer’s sponsorship of the life agent’s licence shall apply also to a life insurer who accepts an application from a life agent whose application for licence was not sponsored by such insurer.”

There are several variations of this alternative:

- a) Remove the provision for single company representation only for agents who have been licensed for at least two years, by amending the words of Section 342(13);
- b) Remove Section 342(13) entirely as it pertains to all licensed agents.
- c) Remove Section 342(13) as a compulsory requirement in the Act, and redefine the authority of the agent as follows, as recommended by LUAC:

“Every life agent’s licence and renewal thereof in respect of life insurance or in respect of life insurance together with accident and sickness insurance shall authorize the agent

- (a) to act as agent on behalf of the sponsoring insurer named in the licence, and
- (b) to negotiate insurance with any other life insurer licensed to carry on business in Ontario where it is clearly in the best interests of the buyer to do so in the following situations:
  - group insurance
  - rated policies

- substantial difference in premium rate or value
- special client relationship with another insurer
- sponsoring insurer will not issue the policy desired.”

d) Remove Section 342(13) as a compulsory requirement in the Act but *without* restricting negotiations with other life insurers to specified situations.

This alternative clearly permits an agent in general or in specified circumstances, depending on the choice of variations within this alternative, to place insurance with other than his sponsoring insurer, if he is not bound by an exclusive or single company contract with that insurer.

4. Remove from the Insurance Act the provision pertaining to single company representation and prohibit its application by contract, but retain the provision for agent sponsorship.

This alternative would free all agents to place business through a choice of insurers, facilitating although not enforcing a system of multi-company representation.

The prohibition of the single company system by contract might be applied only to agents who have been licensed for, say, more than two years.

Prohibition of single company representation with respect to licensed agents might be coupled with amendments to the Act permitting insurers to sell life insurance through exclusive, but unlicensed sales representatives. Responsibility for the actions of these representatives could be imposed directly on the life insurance company that employs them or contracts them.

5. Under a system of multi-company representation, delete the sponsoring requirement and the term “licensed agent” in favour of licensing of brokers. That is only brokers would be licensed. As in alternative 4 above, insurers could be allowed to employ unlicensed, exclusive sales representatives but would not be allowed to call them agents.

Choice of this approach has implications for qualifications, training, and supervision of conduct. It would likely imply less responsibility of insurance companies over the actions of sales intermediaries.

In regard to the Committee’s concern over the quality of information provided to the public, it would seem appropriate under this alternative to include among the responsibilities of licensed brokers, the responsibility to provide applicants with the mandatory disclosure documents required in law and to obtain from insurers the information necessary to complete point-of-sale disclosure forms. These responsibilities would correspond to the insurers’ duty to provide data for purpose of completing mandatory disclosure documents.



6. Retain in The Insurance Act the current or an amended provision for single company representation and agent sponsorship applied to the licensed agent. Amendments could restrict agents to placing business only with the sponsoring insurer, except if the sponsor does not issue the plan of insurance required; or they could provide greater freedom to place business with other insurers.

Institute a second type of intermediary in the sale of life insurance by providing in the Act for the licensing of brokers. Licensed brokers would be permitted to deal with any or all life insurers. They would be permitted to receive fees from the public as well as commissions from insurers.

This alternative corresponds to proposals for amendment to Part XIV with respect to sales intermediaries in the automobile and other general insurance sectors of the total insurance industry.

## **2. The Committee's Recommendations**

The Committee's review of the foregoing alternative approaches to defining the insurer-sales intermediary relationship has led it to the following conclusions, which the Committee believes are in the public interest.

The Committee concludes that retention of the system of single company representation as a provision in law is not in the best interests of all policyholders in this Province. Retention of this provision would not serve the interests of those consumers who wish to deal with a life insurance salesperson who is free to negotiate with any insurer. Furthermore the Committee does not believe that retention of this provision should be necessary to ensure that a mature life insurance industry meets its obligations to serve the life insurance needs of all persons in this Province. The Committee believes that there are many incentives and factors which bind an agent to a company and permit the company to have control over that agent without the need for a mandatory system of single company representation.

- 10.1 The Committee recommends that Section 342(13) referring to single company representation be removed entirely as a compulsory requirement in The Insurance Act, under the conditions that follow.
- 10.2 The Committee recommends that the agent sponsorship provision should be retained, requiring an insurer to sponsor an applicant to act as an agent in selling and servicing his products.

In regard to the requirement that agents continue to be sponsored by insurers, the Committee emphasizes that the sponsoring requirement should not be held as a mere formality. The sponsoring insurer should be held responsible under law for the actions of the agent sponsored.

- 10.3 The Committee recommends that the sponsoring insurer should be permitted to continue using the single company representation system

or a modified system by means of its contractual relationships with its own agents.

- 10.4 The Committee recommends that the agent should be authorized both to act as an agent on behalf of the sponsoring insurer and to negotiate insurance with any other life insurer licensed to carry on business in Ontario subject to the terms of the agent's contract with his sponsoring insurer.
- 10.5 The Committee recommends that the same degree of responsibility for the acts of its agent inherent in a life insurer's sponsorship of the agent should apply also to a life insurer who accepts an application from a life agent who was not sponsored by such insurer.

As outlined above the Committee concludes that single company representation by contractual agreement between the insurer and the agent should be permitted to continue as a practice by those companies wishing to develop an exclusive agency force. In accordance with this conclusion, the Committee does not believe that a requirement in law is needed to retain single company representation for agents in their first two years, as such a requirement could be left to the contractual agreement between sponsoring insurer and agent. Similarly the Committee does not believe it necessary to impose a law that a form of consent be obtained from a sponsoring insurer for business placed elsewhere, as this too should be left as a matter of contract.

- 10.6 The Committee concludes that at the present time it is not prepared to recommend that a change be made in The Insurance Act to provide for licensed brokers. The Committee believes that removal of the single company provision in the Act may facilitate already apparent trends towards development of agents who negotiate insurance with a number of insurers.

The trend toward sale of life insurance by brokers is one which the Committee does not wish to see held back but one which is not sufficiently developed in the life insurance field today to consider in terms of recognition in The Insurance Act. Nor does the Committee believe that the consumer necessarily would be better served by an abrupt deletion of the sponsoring requirement for agents in favour of multi-company representation by unsponsored brokers.

- 10.7 Nevertheless the Committee believes that close attention should be given by the Superintendent to developments in the marketing of life insurance which may at some time lead to the formal recognition in the Act of a new category of sales intermediary, that of the life insurance broker. At that time, attention may be required in regard to licensing and supervision requirements or in regard to some form of self-regulation for the life insurance broker.



## CHAPTER 11

### Licensing, Qualifications, Training and Conduct of Life Insurance Agents

#### A. INTRODUCTION

At the present time, certain standards set by the Superintendent determine the suitability of a person to hold himself or herself out as an agent licensed to sell life insurance. This Chapter consequently sets out to examine these standards in regard to, first, the requirement that a person be sponsored by a life insurance company to be licensed as a life insurance agent; secondly, the matter of agent conduct; thirdly, further qualifications for a licence as a life agent; and, fourthly, licensing examinations and the training of agents. Following this review of the current standards governing the qualifications, training and conduct of life insurance agents, the Committee turns to its own conclusions and recommendations on these matters.

#### B. SPONSORSHIP FOR A LICENCE AS A LIFE AGENT

##### 1. Need to Qualify for a Licence

In order to sell life insurance in Ontario, a person must be licensed by the Superintendent of Insurance as a life insurance agent.

##### 2. Appointment by Life Insurance Company to Act as its Agent

At the present time in Ontario, the licensing of agents recognizes the following two principles of the agency system as outlined in the previous Chapter,

1. Principal insurer-agent relationship: the insurer sponsors an applicant to act as his agent in the sale and servicing of his products.

By an “agent” is meant a “person, who for compensation, . . . solicits insurance on behalf of an insurer or transmits . . . an application for or a policy of insurance to or from such insurer or offers or assumes to act in the negotiation of such insurance . . .”. This definition sets out the agent as an agent of the insurer. Accordingly, The Insurance Act in Section 342 requires that the applicant for the licence of an agent file with his application a certificate from an insurer certifying that he is appointed to act as its agent.

2. Single company representation: Under Section 342(13) of The Insurance Act no life insurance agent can be licensed to act as an agent for more than one insurer transacting life insurance. A consent in writing is required from the sponsoring insurer for insurance placed with any other insurer by reason of inability to negotiate insurance on behalf of the applicant with the insurer for which the agent is authorized to act.



In the previous Chapter, the Committee concluded that, for the present time, there should be only one class of intermediary selling life insurance, that being the agent sponsored by a life insurer.

The Committee also concluded that Section 342(13) of The Insurance Act, pertaining to the compulsory requirement that the agent represent a single company, should be removed but that the provisions in Section 342 requiring insurer sponsorship of agents be retained. The Committee recommended that the agent be authorized to act on behalf of the sponsoring insurer and also be authorized to negotiate insurance with any other life insurer where it is clearly in the best interests of the buyer to do so. Life insurance companies would still be permitted by these amendments to use the single company system by means of their contractual agreements with their own agents.

### 3. The Sponsor's Responsibility

In regard to the sponsorship requirement for agents, which the Committee has recommended be retained in statute, it has been argued that, in many cases "a sponsoring company stands behind the agent only to the extent of filling out a form (for license application)."<sup>1</sup> As this situation is already said to exist, even under a system of single company representation, it is argued that it is likely to continue or become more evident with removal of the provision for single company representation.

It has therefore been suggested that the duties of sponsoring insurers towards the public with respect to their sponsored agents should be defined clearly in The Insurance Act, and/or, that continued government interest should be reaffirmed with respect to licensing life insurance agents and setting standards to be met by an applicant for licence or renewal of licence.

In regard to defining the duties of sponsoring life insurers, LUAC recommends:

- "1. The sponsoring life insurer should be required to undertake, subject to the granting of the licence, to enter into an agency agreement with the applicant, and also to accept responsibility for:
  - (a) ensuring that the newly licensed agent receives supervision, education and training appropriate to the agent's knowledge, experience and progress in the business, and
  - (b) any financial responsibility normally inherent in the principal-agent relationship.
2. The agent should have only one continuing sponsor for one class of insurance business.
3. The single case sponsor is responsible for satisfying itself that the agent

1. Report 2 on *Insurance Study*, to the Superintendent of Insurance, Ministry of Consumer and Commercial Relations, Ontario, Douglas H. Carruthers, Q.C., October 15, 1974.

has the necessary knowledge, experience, and dependability to handle the particular transaction properly.”

The Committee will outline its views on the subject of the duties of the sponsoring insurer at the end of this Chapter, including the duties of sponsoring insurers in supervising agent conduct. The Committee addresses this latter topic next by examining the current division of responsibility for enforcing standards of agent conduct.

## **C. RESPONSIBILITY FOR THE CONDUCT OF A LIFE INSURANCE AGENT**

### **1. The Insurance Act and Other Consumer Protection Regulation**

The conduct of a life insurance agent in serving the public is traditionally a matter of shared responsibility between government and the life insurance industry. Recourse to common law and to competition as regulators of conduct have been regarded as insufficient in the field of life insurance and have been supplemented by provisions in The Insurance Act that define unfair or prohibited practices in the sale of insurance. Many of these provisions pertain to the insurer as well as to the agent; they influence the actions of the agent by their influence on the insurance company in its operations, pricing, advertising and other practices.

The life insurance industry and hence the agent have to a large extent been excluded from general statutes providing for consumer protection, such as The Business Practices Act. Appendix I outlines certain of the provisions of The Business Practices Act. As life insurance does not fall within the definition of “services” in that Act, the Committee has found that the provisions of The Business Practices Act with respect to unfair representations and practices and rescission rights do not apply to life insurance sales. On the other hand, other acts such as The Employment Standards Act and The Pension Benefits Act define how life insurers are to conduct certain parts of their business, but they do not deal to any significant extent with marketing practices. Hence they have little influence on the conduct of agents. As a result, legislative standards of conduct and the authority for enforcement of conduct of life insurance agents reside primarily in The Insurance Act.

### **2. Associations of Life Insurance Agents**

However the Committee has found in other parts of the insurance industry and also in life insurance, that standards of conduct for agents and enforcement of agent conduct exist outside of a legislative framework. They exist as a result of contractual agreements that currently bind most agents to a single insurer. But they also exist in the efforts of associations of insurance agents, such as The Life Underwriters Association of Canada, to develop a

code of ethics and a set of professional guidelines, and to process complaints against their members in respect to these codes or guidelines.

LUAC in its presentation to the Committee summarized its code of ethics as pertaining to the following twelve topics:

- priority of policyowners' interests
- confidential information
- misrepresentation
- defamation
- rebating
- when a sale is to be considered completed
- replacement
- rated policies
- transfer of group insurance
- transfer of pension business
- holding out to the public
- improper advertising

Five additional areas of responsibility to policyowners and prospective purchasers are outside the strict scope of the code of ethics; included are guidelines on the charging of fees and on conflict of interest situations.

LUAC investigates complaints pertaining to contravention of the code of ethics, contravention of the constitution and by-laws of LUAC, violation of life insurance laws and any detrimental act or omission not specifically covered under any of the above. Members who are found guilty are subject to reprimand, suspension of membership privileges for a specified period or expulsion from membership. In all cases where the member is found guilty LUAC prepares a synopsis of the file and forwards it to the provincial Department of Insurance for its information.

LUAC has stated that its administration of a code of ethics applicable to its members has resulted in the Superintendent receiving a far smaller number of complaints against life insurance agents than would otherwise be the case. LUAC has therefore made the following offer of assistance:

“In addition to policing its own members, and cooperating with life insurance companies in seeking solutions to complaints against non-members, LUAC is prepared to assist the provincial Departments of Insurance in the investigation of complaints against life insurance agents made directly to the Department of Insurance and to provide the Department with a full report on any such investigations.”

LUAC has also recommended in its submission to the Committee that the Superintendent be authorized to require adherence to a specific code of ethics as a condition for the issuance and renewal of a life agent's licence. Such code could be a version of the Code of Ethics jointly adopted by CLIA and LUAC.

The Committee's comments with respect to regulation of the conduct of life insurance agents follow as part of the Committee's general observations at the end of this Chapter.

## **D. FURTHER QUALIFICATIONS FOR A LICENCE AS A LIFE AGENT**

Following is a discussion of a number of matters related to the prerequisites for an agent's licence, as set out in The Insurance Act and in regulations. Comments made on this topic by LUAC in its submission to the Committee and by others are included.

### **1. Other Prerequisites for a Life Agent's Licence**

In order to obtain a licence, Section 342(3) of the Act states that the Superintendent must also be satisfied that the applicant is a suitable person to receive a licence and intends to hold himself or herself out publicly and carry on business in good faith as an insurance agent. Regulation 539(4) sets out a series of standards of suitability.

Suitable is defined in the Regulation as including the following requirement that the applicant:

- is of good character and reputation;
- is possessed of a reasonable educational background;
- if previously employed or engaged in business, has a satisfactory record in such employment or business;
- has passed a qualification examination as set by the Superintendent for that purpose;
- is otherwise a suitable person to receive a licence;
- intends to hold himself out publicly and carry on business in good faith as an insurance agent;
- has not made the application for the purpose of obtaining a licence to act as an insurance agent in respect of any particular risk or risks or directly or indirectly to obtain an agent's commission for insurance on his own life or property or on the lives or property of his family, employer or fellow employees;
- or his spouse or, in the case of a corporation, any officer, director, shareholder or employee of the corporation, is not in a position to offer inducement or use coercion or undue influence in order to control, direct or secure insurance business.

The Committee will discuss the topic of the qualification examination as a separate matter in a later section.

Regulation 539(4) furthermore restricts agents from participating in certain occupations or activities in order to ensure that the agent is not in a position to offer inducement or use coercion or undue influence in securing insurance business.



The Carruthers' studies on insurance observed that the practice in Ontario has been virtually to delegate the obligation for determining suitability to the sponsoring insurance company through the wording of the various forms that are filed in support of an application for licence. Mr. Carruthers, now Justice Carruthers, concluded that:

"If the delegation is to remain, then I submit that the Act should be amended to specifically allow for such delegation and at the same time to impose in clear terms standards which the industry must meet before it passes upon the suitability of a candidate and to allow for actions if it fails to do so."<sup>1</sup>

While Regulation 539 does stipulate certain standards with respect to an application for licence, the obligation for determining suitability according to these standards continues to be delegated to the insurer.

## 2. Agent Bonding

The Life Underwriters Association of Canada would like one further condition to be added to the prerequisites for licensing, that "all applicants for a life agent's licence should be required to submit evidence that they are eligible for bonding as an individual without security in an amount to be determined by the Superintendent of Insurance".

The reason for this further condition is because life agents, who may handle funds which are presented to them in trust, should have a reputation and standing as individuals that would enable them to obtain a surety bond without security being deposited.

Other suggestions have been put forth regarding agent liability and financial responsibility; for example, that life insurance agents actually furnish a bond in an amount and under terms specified by the Superintendent and that life insurance agents hold errors and omissions insurance coverage as a condition of being insured.

## 3. Full-Time Concept

The Ontario licensing regulations permit an agent to have another occupation, that is, work as a part-time agent, only if the agent is resident in a township or municipality with a defined low population or if he or she is a real estate broker or salesman or carries on the business of a transportation company or ticket agency and sells travel, accident and baggage insurance.

The basic concept of life insurance selling, as promoted by LUAC and CLIA, is that a life insurance agent's earned income must come *entirely* from the insurance business. The LUAC Principles of Life Agency Operations provides for two exceptions to this full-time concept:

1. Report 1 on *Insurance Study*, Douglas H. Carruthers, Q.C., December 12, 1973, page 14.

- a probationary six month licence to enable an applicant to continue an existing business for six months;
- a real estate agent's licence, where combined with a general insurance agent's licence, may also be held with a life agent's licence.

The LUAC further recommends that a licence should not be issued “to anyone engaged in another occupation other than as a general insurance agent or as a mutual fund salesman where there is a corporate relationship or special agreement between the life insurer and the mutual fund”. These recommendations are made by LUAC as they believe they will improve the quality of licensed agents, who should devote their full time to the occupation of life insurance.

#### **4. Undue Influence**

An attempt is made by the licensing regulation to prevent an insurance agent from unduly influencing or coercing a prospective client into buying insurance. Situations where this could occur are outlined in Regulation 539(4)(2).

The LUAC believes that the current regulation is deficient to the extent that it does not at present extend to officers or employees of an investment dealer, or to the minority shareholders of a corporate life insurance agency. They recommend changes, as follows:

- “A life agent's licence should not be issued to a person employed by or controlled directly or indirectly by any person or corporation engaged in the business of investment, banking, trustee services, credit union or other financial services.”
- “A life agent's licence may be issued to a corporation where the full ownership of the corporation is held by a person or persons who qualify in every way as full-time life insurance agents.”
- “A life agent's licence may be issued to a corporation where the licensed person or persons owns the controlling interest in the corporation provided that the minority interest is not owned or controlled directly or indirectly by an investment dealer, bank, trust company, credit union or other financial institution.”

#### **5. Holding Out to the Public**

LUAC states that Section 342(3) of The Insurance Act includes a general statement as to “holding out to the public”. This section requires the Superintendent prior to issuing a licence, to satisfy himself that the applicant “intends to hold himself out publicly and carry on business in good faith as an insurance agent”. LUAC states that this wording has proved to be too general and ineffective in ensuring that the true status of an agent is not obscured in representations before the public.

Hence LUAC recommends that the statute or regulations thereunder respecting licensing and holding out requirements for life insurance agents should specify in more detail appropriate forms of agent representation on all letterheads, business cards, written proposals and advertising. LUAC also recommends that an agent be prohibited from holding himself or herself out as offering counsel in the fields of law, accounting, taxation or investment unless so qualified as a professional in those fields.

## **6. Licensing of Partnerships and Corporations**

LUAC states that there is a growing trend for two or more agents to carry on a joint practice either in partnership or in association. As a result, LUAC recommends that:

“Sponsorship by a life insurer, not necessarily the same insurer, should be required for the licensing of each representative of the partnership or corporation and for the licensing of the partnership or corporate entity itself.”

LUAC also recommends that Regulation 539 pertaining to licensing of agents be amended so that the control of a business entity which rests with the Superintendent and which currently applies to corporations be expanded to apply also to partnerships in a consistent manner.

LUAC further recommends that:

- “Where an individual, partnership or corporation applies for a life agent’s licence, the name of the entity to be licensed must be the name of the principal individual or individuals and trade names which mask the identity of the individual should not be used.”
- “Where the entity is a corporation, the corporate name should include at least the name of the principal licensed agent or agents followed by the words “Insurance Agency Ltd.”.”
- “The company’s branch of the provincial government should ensure that all new applicants for incorporation are informed of the name requirements in paragraph 2 above.”
- “Where the name of an individual, partnership or corporation licensed to carry on business as a life insurance agency is accompanied by the words “and Associates”, at least one of the Associates must be a directly associated licensed agent who is in a position to ensure continuation of the services of a qualified life agent to the existing clients and policyowners of that agency.”

## **7. Non-Resident Licensing**

It has been proposed by the Ministry of Consumer and Commercial Relations in its 1978 proposals to amend Part XIV of The Insurance Act, that



the sale of new life insurance by a non-resident agent be prohibited. As a result, the agent with a non-resident licence would only be permitted to service existing contracts of insurance and not to solicit insurance.

LUAC is opposed to this proposal, especially as it applies to agents selling and servicing group plans of insurance. LUAC argues that “when one province erects legislative or administrative barriers against residents of other provinces, such action invites retaliation in kind”. LUAC therefore recommends, for the Committee’s consideration, that:

“The Province of Ontario should take the lead in implementing an open system of reciprocal licensing of residents of other provinces of Canada as life insurance agents.”

## **8. Other Persons Advising, Selling or Servicing With Respect to Contracts of Life Insurance**

Various persons offering counsel in the fields of investment counselling, financial planning and employment benefits planning use of term “consultant” to describe the advisory services they provide to their clients, usually on a fee for service basis. In some cases, the counselling offered by such consultants pertains to life insurance matters. Conversely, some life insurance agents hold themselves out as skilled in financial planning or employee benefits planning and use the term consultant to underscore their qualifications in these fields.

LUAC contends that there is no real public need or desire for “life insurance consultants” as a separate category of intermediary in life insurance matters. LUAC states that, if at any time there is a demand for life insurance consultants, then their status and qualifications must be defined and a special category of licence established.

The Carruthers Report on Insurance to the Ministry of Consumer and Commerical Relations in this Province took a different view and advocated the establishment of a category of licensed intermediaries to be known as consultants. LUAC, in response to the Carruthers Report, did suggest at that time some of the terms and conditions that would have to be established to create a category of consultants, but did not discuss these suggestions in its presentation before this Committee.

Instead LUAC expressed its members’ concern that any association of the term consultant with life insurance matters creates confusion. Therefore, LUAC recommends that:

- “1. Any person licensed under the Insurance Act shall not hold himself out to the public as a consultant on life insurance matters.
2. Any person not licensed under the Insurance Act shall not hold himself out as qualified to act on a fee basis as a consultant on life insurance matters.”



Discussion now turns to the topic of the licensing examination, as a prerequisite for a life insurance agent's licence.

## **E. LICENSING EXAMINATIONS AND THE TRAINING OF LIFE INSURANCE AGENTS**

### **1. The Licensing Examination**

#### *History and Objectives*

Lack of formal evidence of the ability of the agent to serve the public grew in concern in the 1960's, both to the public and to life insurance agents, who increasingly saw themselves as full-time professionals with a duty to the consumer.

In 1968, LUAC and CLIA recommended to the Association of Superintendents of Insurance that a system of written examinations be instituted for new applicants for licence as a life insurance agent.

But it was not until 1971 that regulations were promulgated in Ontario which required an applicant for a life agent's licence to pass a qualification examination set by the Superintendent of Insurance. As a result, over the last nine years, the government in Ontario has undertaken the role of assuring the consumer that the licensed agent in this Province has at least a basic knowledge of life insurance and the laws pertaining to life insurance contracts.

#### *Licensing Examination Procedures*

To obtain a life insurance agent's licence, the prospective agent must apply with the appropriate fee to the Superintendent's Office, and at the same time, name his sponsoring company. Upon review of the applications, the Office then informs the applicant that he has 30 days in which he may write the licensing examination.

The prospective agent must write two examinations: the examination for his life licence which includes an examination to be licensed to sell life insurance and an examination to be licensed to sell accident and sickness insurance. Both examinations must be passed at the same sitting in order to obtain the licence.

The initial licensing examination is an objective multiple choice examination which is a test of basic factual knowledge and does not require problem solving or expressions of opinion. Its purpose is to ensure that the applicant has an acceptable level of knowledge of how life insurance works and the laws applicable to life insurance contracts and to agents.

#### *Data on the Licensing Life Examinations in Ontario*

In the years 1977 and 1978, a total of 7,958 life insurance examinations

were sent out by the Department of Insurance in response to applications for life licences. Approximately 73 percent of the examinations sent out and delegated to examination sites were returned to the Department, indicating that some 27 percent of applicants did not sit for the examination. Of those writing, the Department has calculated an average failure rate for these two years of about 29 percent. Hence out of the original number of applicants, approximately 53 percent became eligible to be issued a life insurance agent's licence.

## **2. Training of Life Insurance Agents**

### *New Agent Training*

A great amount of effort and research has been devoted to the development of appropriate training programs, for agent recruits and for newly licensed agents. The life insurance industry as a whole has demonstrated significant sophistication in the recruitment of new agents, in the development of training materials and in the organization of training programs.

There is, however, a dual purpose to the training of new agents—sales and service. This duality of purpose has an influence on the approach to recruitment and training that is taken by the insurance industry. For example, in order to justify the cost of training, it becomes necessary for the new agent to become licensed and hence directly involved in selling at an early stage. In many cases, training is then continued on the job, under the supervision of a branch manager or supervisor, often supplemented by more formal courses, provided by company trainers or through LUAC.

### *Increasing the Qualifications of Life Insurance Agents*

The life insurance industry provides excellent opportunity for the agent to improve his knowledge and sales techniques in the field of life insurance. First, the Chartered Life Underwriter designation was developed as early as the 1920's, as an indicator of educational achievement and competence. Second, the need for a good program of basic and intermediate training became apparent in the 1940's and resulted in the LUATC program of on-the-job education.

Third, in recent years the industry has undertaken to provide various continuing education programs and special interest seminars to both agents and other industry personnel. These programs have been fully described to the Committee by the CLIA, LUAC and individual insurance companies.

As with licensing examinations, neither the existence of these programs nor participation in them necessarily guarantee competence. But they do demonstrate the industry's overall commitment to improving the effectiveness of its distribution system in service as well as in sales.

## **3. Observations on Agent Training**

The Committee in previous Reports was concerned that the consumer

may perceive the licence backed by a licensing examination as an assurance of competence. The Committee was particularly concerned about this misconception in the case of newly licensed agents. It was recognized by the Committee and is recognized by the industry that examinations based on elementary studies, largely unrelated to the practical application of the knowledge learned, have severe limitations in terms of evidence of competence in performance.

On the other hand, it is evident that specialized knowledge or skill is not required by every agent or for most day-to-day duties. In addition, high standards of qualification imposed on all agents may be discouraging to the entry of new agents into the life insurance field. For these reasons it would seem inappropriate that all agents be required to undergo a rigorous and complex program of qualifications and training.

It is also evident that competence is an objective reached through continual learning, both formally and on the job, and through experience in dealing with consumers. It is evident that neither lax nor stringent qualification standards can accomplish this objective alone. Nonetheless, the following concerns have been expressed with respect to qualification standards and are noted by the Committee:

- The qualification examinations for licensing have been criticized as having severe limitations in terms of qualifying an applicant properly for the sale and service of life insurance. The preparation period for this exam is short and it is recognized that *basic* training must continue after licensing. Some new agents, however, will not receive adequate training and supervision after initial licensing.
- Further company training may be conditional on some measure of sales performance. Likewise, participation in LUATC courses is tied into a minimum amount of sales exposure. As a result many new agents may lack skills in servicing their initial clients.
- Training varies considerably, even in the same company, depending on the skills and attitudes of the trainers. Responsibility for training is not consistently defined across the industry. This diversity in training and consequent skills is often not recognized by the consumer.
- The concentration of basic training within the company or agency branch means that the new agent may not become exposed for some time to the products and services of other companies in the industry. As a result, the consumer may not receive the full range of advice necessary to his individual needs and circumstances.

#### **4. Proposals to Improve Qualifications**

Provided below are a number of proposals intended to improve the qualifications of licensed agents. These proposals, as drawn to the Committee's attention, include:



1. LUAC recommends that the present examination system for new life agents be continued, under the jurisdiction of the Superintendent of Insurance, with the study manual and examination questions being reviewed regularly to ensure that examination standards are maintained at a satisfactory level, having in mind the need for purchasers of life insurance to be properly advised. LUAC also recommends that the passing requirement for the initial licensing examination be increased from 70% to 75%.
2. Others have proposed the establishment of an institutional program for newly appointed agents which prepares newcomers for the initial licensing examination and continues basic training after licensing. This program could be provided in industry sponsored schools or in public education facilities such as community colleges, as recommended to the Committee by the Consumers' Association of Canada. To quote the C.A.C., it is proposed:

“That the education and training of agents be removed to community colleges so that new agents do not have to depend on a company for their training.”
3. An alternative proposal is to institute a process of “step licensing” wherein a temporary licence is granted after successful completion of an examination testing basic knowledge with the requirement that the new agent complete an approved course of study and/or pass a more comprehensive examination within a specified period of time to obtain a permanent agent's licence.
4. LUAC has commented on the promulgation of mandatory continuing education requirements for licence renewal. LUAC recommends in particular that consideration should be given to improving the quality, performance and retention of life agents by requiring that on renewal of a licence for the first three or four years there shall be specified educational requirements based on the LUATC or such other courses as may be recognized by the Superintendent of Insurance. Failure to meet the qualification standards would lead to suspension of the licence.
5. LUAC has also recommended, for the Committee's consideration, the following:
  - “That an applicant for a life agent's licence who holds the Canadian C.L.U. designation should be exempt from the licensing examination requirement.”
  - “That a life insurance agent in Ontario who remains qualified as a full member of LUAC should be authorized to use the membership card in lieu of a renewal of the life agent's licence by the Superintendent of Insurance.”

The Committee will comment on these proposals and in general on the matter of qualifications and training of agents in the next section.



## F. OBSERVATIONS ON THE LICENSING OF LIFE INSURANCE AGENTS

In reviewing the current system of regulation of life insurance agents, the Committee has come to the following conclusions.

### *Government Supervision Over Life Insurance Agents*

The Committee is concerned that government supervision as currently exercised over licensed life insurance agents is not a satisfactory means of ensuring the competence and proper conduct of life insurance agents in this Province. However, the Committee does not believe that enactment of more stringent qualification and conduct standards in The Insurance Act or in regulations under the Act would necessarily be an appropriate direction for the government to follow in improving the quality of sales and service to the customer.

The Committee therefore turns to the life insurance companies, who act by statutory requirement as sponsors of life insurance agents, to take on the responsibility for improving the qualifications of agents and overseeing their conduct. The Committee believes that the industry in this Province is sufficiently mature to take on this “public” responsibility and in fact should take it on as a major financial institution acting as a trustee for the policyholder funds of a significant number of Canadians.

With such delegation of responsibility for life insurance agents to the life insurance companies, the government interest on behalf of the consumer could be exercised through its direct regulation of the life insurance companies, including as part of the government’s regulatory focus review of how well insurers are meeting their duties to supervise and train their agents.

### *Responsibility Inherent in Sponsorship of an Agent*

In the previous Chapter, the Committee recommended retention in The Insurance Act of the provision that an agent must be sponsored by a life insurer in order to act as an agent in the negotiation of life insurance. This recommendation is essential to the Committee’s further recommendations in this Chapter. It must, however, be supported by the following ancillary recommendations:

- 11.1 The Committee recommends that the sponsoring life insurer should be delegated responsibility in The Insurance Act for ensuring that its agent receives supervision, education and training appropriate to the agent’s knowledge, experience and progress in the business.
- 11.2 The Committee recommends that the sponsoring life insurer should also be required to accept responsibility for the acts of the agent and for any financial responsibility normally inherent in the principal-agent relationship, subject to any form of indemnity agreements between the insurer and the agent.

- 11.3 The same degree of responsibility for the suitability and acts of its agent inherent in a life insurer's sponsorship of the life agent should apply to a life insurer who accepts an application from a life agent not sponsored by such insurer.

*Elimination of the Requirement for Government Licensing of Life Insurance Agents*

On the basis of the foregoing conclusions and recommendations, the Committee believes that a lesser government role in agent supervision can be justified, given that life insurance companies meet their obligations with respect to agent supervision, in an appropriate manner. The Committee will comment on its views in regard to insurer responsibilities later in this section.

The Committee's primary conclusions in regard to future government supervision of life insurance agents are as follows:

- 11.4 The Committee recommends that the requirement for the Superintendent of Insurance in this Province to licence life insurance agents should be removed from the Insurance Act.
- 11.5 In place of licensing, the Superintendent should undertake, as a public service, the registration or recording of names of life insurance agents sponsored by life insurance companies. The duty of life insurance companies to keep the Agent Register records up-to-date should be made a statutory duty.

Persons selling life insurance and not on the Agent Register should be held as guilty of committing an offence under The Insurance Act, unless such persons are of a class of sales intermediary specifically exempted from registration.

These requirements should replace the current provisions in Part XIV of The Insurance Act.

- 11.6 The Committee recommends that non-resident agents be subject to separate regulation under the Act and /or to a form of licensing if such is found to be necessary by the Superintendent.
- 11.7 The Committee recommends that salaried employees of a licensed insurer who act for such an insurer in the negotiation of any contracts of life insurance or annuities or their renewal need not be required to be registered with the Superintendent as life insurance agents. These persons would not, however, be given the authority to negotiate insurance with other insurers.

On the other hand, the Committee recommends that commissioned exclusive life insurance agents, bound to a single insurer by contract, should be registered as agents with the Superintendent.

Should the government decide not to carry out the Committee's recommendation with respect to the elimination of the licensing of life insurance agents, the Committee has made a number of recommendations for changes pertaining to the regulation of agents under the present system of licensing. The Committee directs the reader to these recommendations at the end of this section as essential to an improved system of licensing of life insurance agents.

### *Supervision of Agent Conduct*

While the Committee believes that government involvement in the licensing of life insurance agents should be eliminated, the Committee concludes that government interest in the conduct of life insurance agents should continue. The Committee addresses the following recommendations in regard to the handling of complaints about agent conduct and, secondly, in regard to regulations pertaining to definition of standards of agent conduct.

- 11.8 Should a public complaint arise in regard to an agent, the Superintendent should identify the sponsoring company of the named agent from the Agent Register and should direct all complaints to the sponsoring insurer for resolution or correction.

If the complaint involves insurance negotiated with other than the sponsoring insurer, then the life insurer accepting the application from the agent should be required to resolve or correct the complaint.

If complaints arising in regard to unfair or deceptive acts as practised by agents are not satisfactorily resolved by the insurer involved, the Superintendent should be authorized under the Act to take action against the insurer under authority of Part XVIII of The Insurance Act.

- 11.9 The Superintendent should maintain a record of complaints by agent, by company and by reason for the complaint. The Superintendent should publish annually in his Annual Report a summary review of the complaints registered with him, by name of the company for which the agent acted.
- 11.10 Where persistent or serious complaints arise with respect to the acts of any one named agent, the Superintendent should be authorized to strike the name of that agent off the Agent Register, subject to an appeal process.

The Superintendent's authority to determine what constitutes persistent or serious complaints should be defined under provisions in Part XVIII of the Act and under provisions in The Business Practices Act, with the intent that these provisions be indicative of the unfair prac-

tices which might warrant the striking of the name of an agent off the Agent Register.

On the matter of regulations pertaining to definition of standards of agent conduct, the Committee makes the following observations and recommendations.

The Committee has considered the concept of incorporating in regulation a code of ethics governing the conduct of life insurance agents. The Committee is not, however, satisfied that specification in statute or in regulations of a code of ethics applicable to life agents is required at the present time, given already existing provisions in the Act which set out unfair and deceptive acts and practices and which pertain to *all* persons engaged in the business of insurance.

The Committee concludes instead that consumer protection against the unfair and deceptive acts and practices of both agents and insurers be reinforced by extending the provisions of The Business Practices Act to the life insurance industry. The Committee's conclusions in this regard follow, along with supplementary recommendations dealing with Part XVIII of The Insurance Act.

- 11.11 The Committee recommends that the Minister of Consumer and Commercial Relations introduce an amendment to The Business Practices Act so as to make it applicable to life insurance and to insurance in general.

In particular, the Committee recommends that the provisions of The Business Practices Act which pertain to:

- (a) a false, misleading or deceptive consumer presentation
- (b) an unconscionable consumer representation
- (c) and any other unfair practices that fall under that Act,

should apply to the life insurance industry and to all persons involved in the marketing and counselling of consumers in regard to a program of life insurance.

- 11.12 The Committee further recommends review of the parts of The Insurance Act that pertain to agent conduct, in particular Part XVIII of the Act which deals with the "unfair and deceptive acts or practices in the business of insurance", in regard to any modifications that may be needed to include the thrust of the provisions of The Business Practices Act in that Act's elaboration of false, misleading, deceptive or unconscionable consumer representations.

- 11.13 In general, the Committee recommends that the authority given to the Superintendent under Part XVIII of the Act to investigate agent and insurer conduct should remain broad in scope and should be supplemented by intermediate penalties, as well as the penalty of prohibit-



ing the agent or the insurer from engaging in the business of life insurance. In the event that complaints warrant that action be taken against an agent under Section 388 of Part XVIII of the Act, the Committee recommends that action should also be allowed against the sponsoring insurer or the insurer of account on the basis of the same complaint.

### *Establishing the Suitability of Persons Wishing to Act as Life Agents*

The Committee now turns to discussion of the duties of the sponsoring life insurance company with respect to establishing the suitability of persons wishing to act as life agents. The Committee's general expectation is that life insurance companies will consider the matters currently set out in Regulation 539 as a guide toward establishing the suitability of persons wishing to act as life agents. More specifically, the Committee makes the following recommendations.

11.14 The Committee recommends that life insurance companies take into account the following matters in sponsoring a person to act as a life insurance agent:

- That the applicant is a suitable person, in terms of character, reputation, educational background and previous record in business to hold himself or herself out publicly and carry on business in good faith as an insurance agent.
- That neither the applicant nor his spouse, nor *any* officer, director, shareholder or employee of a corporation, nor any partner or employee in a partnership, where sponsorship is extended to a partnership or a corporation, should be in a position of undue influence or self-interest to secure insurance business.
- When sponsorship is extended to a partnership or corporation, that sponsorship should be extended to each representative of the partnership or corporation in the business of life insurance.

The Committee has also given consideration to evidence of eligibility for bonding as a possible prerequisite for an applicant wishing to act as a life agent. However, the Committee believes that such a requirement is not essential from the public's point of view in light of the responsibility of the sponsoring insurer for the actions of its agents.

The Committee has also given consideration to the concept of full-time agents in the life insurance business. Regulation 539 under The Insurance Act currently restricts licensed agents in carrying on any other business or occupation, except that of a real estate business or a travel business and except in areas of low population. The Committee is of the opinion that, while the full-time concept has merit for the majority of agents, it should not be made a prerequisite for all agents in all situations.

- 11.15 The Committee recognizes the continuing need for part-time agents and encourages life insurers in setting their own requirements of suitability for agents to allow, at the least, part-time agents in those circumstances presently specified in Regulation 539 or, preferably, to permit agents to be part-time agents in other circumstances where their further activity, occupation or business does not result in a position of undue influence on prospective policyholders.

The Committee believes that the full-time concept, as applied to all agents, may in some instances such as in small communities result in undue pressure to sell insurance in order to maintain a suitable income, possibly to the detriment of the policyholder and the services he receives. The Committee recognizes nevertheless that many occupations exist which could be construed as putting the agent in the position of influence over the prospective policyholder. The Committee believes that life insurance companies should be held accountable for denying sponsorship to agents where such conflicts could occur.

#### *Holding Out to the Public*

- 11.16 As a related matter to that of the further occupation or activities of life insurance agents, the Committee recommends that the sponsoring insurer undertake to ensure that the true status of its life insurance agents is not obscured in representations to the public.

Insurers should ensure that all their agents:

- state that they are a life insurance agent in regard to any business which may and does result in negotiation of an insurance program;
- name the sponsoring insurer;
- advise the prospective policyholder whether or not he is bound by contract to a single insurer;
- state the situations in which he is free to place insurance with other insurers, if bound by contract to a single insurer.

- 11.17 In the matter of life insurance agents who hold themselves out as “consultants”, the Committee recommends that such holding out need not be prohibited, but that life insurers should ensure that their agents disclose in a non-ambiguous fashion, in any situation where they call themselves “consultants” in life insurance or in financial or estate planning matters, that they are also sponsored and commissioned agents, who obtain remuneration from the life insurance companies with which they place insurance business.

- 11.18 In regard to persons who call themselves “life insurance consultants” but are not agents or employees of life insurance companies, that is are not permitted to take applications for or negotiate contracts of life insurance, the Committee concludes that such persons should

not be prohibited by The Insurance Act from using the term “life insurance consultant”.

### *Agent Education and Training*

The final matter which the Committee wishes to address in regard to its expectations of the life insurance industry in supervising life insurance agents is the matter of the agent’s education and training.

- 11.19 The Committee recommends that satisfactory completion of a basic course should be required of every applicant wishing to become an agent before sponsorship is granted to him or her to act as an agent. The basic course should be made a common course for all applicants.

The Committee recommends that responsibility for development of and continuing public access to a basic course qualifying a person to be sponsored as an agent should be delegated to the life insurance companies in this Province.

- 11.20 The Committee further recommends that this basic course be held in a “public forum”, so that it does not become dependent on the facilities or training staff of any one insurer. Preferably the course should be held in a public educational facility.

The Committee recommends that the industry discuss the matter of basic agent training with public education officials as a form of vocational training, with the intention that the network of community colleges in this Province might accommodate this vocational training program.

The Committee recommends that insurers should be prepared to pledge to public education officials that they will assume some part of the cost of the basic training program and that they will contribute to the staff and curriculum development of these courses.

- 11.21 The Committee recommends that the development of the basic course and its completion standards be carried out by the industry, with the full cooperation of industry associations including the CLIA and LUAC and with the participation of public education representatives and the Office of Superintendent.

The completion standards for this course should be significantly improved over the standards of the present qualifying examination for a life agent’s licence.

- 11.22 If life insurance companies fail to respond to this recommendation within five years, the Committee recommends that the Superintendent of Insurance move to set up a basic training course and introduce

amendments to The Insurance Act requiring all agents to participate and pass the examination in such a course.

Further and ongoing training should, in the Committee's opinion, be left to individual companies and to associations of agents such as LUAC. The Committee has, for the time, decided not to recommend the idea of mandatory ongoing educational or requalification requirements.

### *In the Event the Government Continues Licensing of Life Agents*

11.23 In the event that the Committee's recommendations with respect to suspension of the licensing requirement for life insurance agents are not followed by the government, the Committee recommends:

- That agents be permitted under The Insurance Act to negotiate insurance with other than their sponsoring insurer, if allowed by contract, as recommended by the Committee in its recommendation 10.1 in Chapter 10.
- That sponsorship of life insurance agents by a life insurance company continue to be required under the Insurance Act, as recommended by the Committee in its recommendation 10.2 in Chapter 10.
- That The Business Practices Act be amended to make it applicable to life insurance and to insurance in general, as recommended by the Committee in this Chapter in its recommendation 11.11.
- That the parts of The Insurance Act that pertain to agent conduct be reviewed and revised to include the thrust of the provisions of The Business Practices Act in that Act's elaboration of false, misleading, deceptive or unconscionable consumer representations, as recommended by the Committee in this Chapter in recommendations 11.12 and 11.13.
- That responsibility for determining suitability of an applicant for licensing, in accordance with the current or revised regulations under the Act, that pertain to suitability, be delegated formally in The Insurance Act to the sponsoring insurer.
- That agents be permitted, under The Insurance Act and its regulations, to act as part-time agents, in specified circumstances, as referred to by the Committee in this Chapter in its recommendation 11.15.
- That the situation of corporations and partnerships sponsored as life insurance "agencies" be fully considered in The Insurance Act and regulations, to ensure that proper representation is made to the public, as determined to be appropriate by the Superintendent.



- That improved specification of holding out requirements and including reference to disclosure of the status of exclusive agents bound by contract to a single insurer be incorporated in The Insurance Act and regulations, specifically as recommended by the Committee in this Chapter in its recommendation 11.16.
- That The Insurance Act require disclosure of the status of a person as a commissioned life insurance agent for those agents holding themselves out as “consultants”, as recommended by the Committee in this Chapter in its recommendation 11.17.
- That The Insurance Act and regulations recognize reciprocal licensing of non-residents as life insurance agents.

11.24 In the event that the government in this Province decides to retain the licensing requirement for life insurance agents, the Committee recommends that, in regard to the matter of agent conduct, requirements pertaining to the conduct of licensed agents be referred to in The Insurance Act and prescribed in regulation and that these require the agent:

- To ensure that in any contact with the public in matters of life insurance or annuities, it is made absolutely clear:
  - that he or she is a life insurance agent;
  - whether or not he or she is bound by contract to a single insurer; and
  - the situation(s) in which he or she is free to place insurance with other insurers.
- To enter all information required to be completed by the agent on mandatory disclosure documents provided to the prospective insurance purchaser at the point of sale.
- To safeguard any information which is given to him in confidence by policyowners or prospective purchasers.
- To attempt to have a medical, occupational or other rating removed from an existing policy in those instances where it becomes known that such a reduction may be possible.

The Committee recommends that the Superintendent give consideration to any other standards of conduct which should be imposed in regulation on licensed agents to ensure that agents act in the best interests of the policyowners.

In his consideration of any further standards of conduct which should be imposed in regulation on licensed agents, the Superintendent might take into account the code of ethics developed by LUAC for its own membership. However, the Committee is not satisfied that the LUAC code of ethics

is suitable in its entirety for application to all licensed agents. In particular, the Committee is not satisfied that portions of the LUAC codes that pertain to replacements and transfers of business ensure that replacements and transfers of business which are in the policyholder's interest are effected without undue difficulty, that is, are not hampered by code provisions.

11.25 In the event the government in this Province decides to retain the licensing requirement for life insurance agents, the Committee recommends, in regard to the matter of training, the Superintendent delegate the responsibility for establishing the training and examination requirements for qualification for a new agent's licence to the life insurance companies, in accordance with the Committee's recommendations in this Chapter, that is recommendations 11.19 to 11.22. Under these recommendations, the Committee expects the industry to develop a common, basic course for all new agents, with this course to be held in public educational facilities. Completion of such a course, or some designated part of this course, should be required before application for the licence of an agent.



## CHAPTER 12

### Remuneration Methods For Life Insurance Agents

#### A. INTRODUCTION

The preceding two Chapters of this Part have dealt with the general subject of marketing life insurance in the Province, some aspects of the agency system and, in particular, the licensing, qualifications, training and conduct of life insurance agents. This Chapter now turns to the methods of remunerating life insurance agents with a review of the general nature of the current plans to compensate agents, a discussion of some of the issues regarding these plans and the Committee's observations and recommendations on the subject.

#### B. CURRENT REMUNERATION METHODS FOR LIFE INSURANCE AGENTS

There is a consensus among life insurers that in order to motivate an agent to sell life insurance products, it is necessary to relate his or her remuneration, in some way, to the premiums on the policies sold by the agent. Agents therefore are generally compensated in the framework of a commission structure. A commission is said to provide the best incentive for an agent "to persuade an individual that a need for services exists and to secure action on that persuasion".

Within this concept, however, individual companies have developed a variety of remuneration plans. Frequently, these plans are very complex. The differences in the various agent remuneration schemes designed by life insurers is reflected not only in the rates of commission for the sales of different policies, but also in the deferral of commissions, the length of time over which commissions will be paid, the vesting of commissions, supplementary bonus arrangements, commission adjustment rules, compensation for policy service and so on.

It is difficult to generalize about the agent remuneration plans of insurers since as far as the Committee is aware no two insurers carrying on business in Ontario have identical plans. Each insurer has evolved a method of remunerating its agents with its own particular marketing strategy in mind and its perception of the agents' role in that strategy. The general overview of remuneration methods which follows therefore is not intended as an all-inclusive summary of the industry's practices for remunerating agents, but rather is designed to indicate some of the more significant matters pertaining to remunerating methods for agents that have come to the attention of the Committee and its staff.

This overview of the current remuneration methods of agents in Ontario is summarized under the following main headings:



- agent remuneration—life insurance
- agent remuneration—annuities
- broker remuneration—life insurance and annuities

## **1. Agent Remuneration—Life Insurance**

Comments concerning the current remuneration methods for life insurance agents on sales of life insurance are dealt with under a number of topics each of which is considered in the design of an agent remuneration plan by a life insurer.

### *Type of Coverage*

Sales commissions are paid to the agent under the terms of the agent's agreement with the company. Commissions are calculated as a percentage of the premium for the life insurance protection sold. One of the major factors influencing the rate of commission on a particular sale is the type of basic insurance or the type of coverage sold. The following comments relate to this topic:

1. Rates of commission on basic insurance premiums are usually categorized by insurers as applicable to whole life, endowment and term policies, but there are many variations in rates of commission paid by most insurers within these basic categories.
2. Commissions are most commonly paid over the first five policy years although some companies pay commissions over shorter or longer periods. The duration of the commission-paying period is normally the same for all products sold by a company.
3. There is no universal practice among insurers as to the level of rates of commission paid for the basic types of life insurance, that is, whole life, endowment and term.
4. Generally, higher commission rates are paid on whole life policies than on endowment policies. The difference in rates is usually greatest for short premium-paying periods and becomes less significant with longer premium-paying periods. The maximum difference in first year commission rates would appear to range from 12.5% to 20%.
5. Some companies, but not all, design their commission rate schedules so that the difference in rates of commission for whole life and endowment policies are insignificant if the premium-paying period is very long, for example, 33 to 40 premium-paying periods.
6. Renewal commissions for whole life and endowment policies may be different or identical. However, the general pattern of higher commission rates in total for whole life policies remains and the rates paid for renewals may only narrow the gap resulting from the first year commission differences.

7. The majority of insurers carrying on business in Ontario pay higher rates of commission on their whole life policies than for their term policies. While it is difficult to generalize, it would appear that the difference in the rates of commission normally range from 10% to 40%. The differences are usually most significant for the shorter premium-paying periods and are smaller for longer premium-paying periods. While it is not universal, a few companies pay rates of commission to their agents that are very close to the same rates for whole life policies and term to 65 policies.
8. As a direct reflection of their marketing strategy, a few companies pay higher rates of commission on their term policies than on their whole life policies.
9. Renewal commissions for term policies are generally lower than for whole life policies excepting in the case of the relatively few companies who are specifically promoting term policies as part of their marketing strategy.
10. It is almost universal that the rates of commission paid on term policies for very short premium-paying periods are higher than for endowment policies for comparable periods, but that when the premium-paying period is extended, the rates of commission paid on endowment policies are normally higher than for term policies. In the case of extended premium-paying periods, a few companies have rates of commission that are very close to being equal for their endowment and term policies.
11. Some life insurers have designed their commission rate schedules to pay slightly higher rates for either their participating policies or their non-participating policies. There does not appear to be any general pattern in this regard nor does the practice appear to be common since where there are different rate schedules for participating and non-participating policies there is often little or no product overlap offered by the company.
12. There is usually a limit on the commissions that can be earned by an agent on the basic insurance policy. The limit is most commonly applied by specifying that the commission rates in cases where the applicant is over a certain maximum age will be the rates applicable to the premium if the applicant was the maximum age. The age limits commonly used are 60 and 65 years of age. Other insurers limit commissions on an individual sale by specifying the maximum commission earnable per \$1,000 of basic policy coverage.
13. Relating the rates of commission on various types of policies to the premium-paying period is a very common practice although not a universal one in the industry. Where it is used, higher rates are invariably paid for

longer premium-paying periods. If this practice is not followed by an insurer, it may have an alternative practice whereby it may establish its range of commission rates based on the age of the applicant at the time of issue of a policy. Companies using this practice pay higher rates for policies issued to younger applicants. These insurers assume that once an applicant becomes a policyholder, he or she will remain one and continue to pay premiums for a long period.

14. The basic commission obtained on group insurance contracts is usually scaled on a declining rate basis depending upon the size of the premium. Sales commissions are paid in the first policy year on group insurance contracts since normally these contracts are subject to renegotiation annually by the group policyholder.

### *First Year and Renewal Commissions*

As noted, insurers most commonly pay commissions to agents over the first five years although some companies pay commissions for either shorter or longer periods.

1. Whether the commissions are paid by an insurer to an agent over a very short or much longer period of time the total commissions expressed as a percentage of the premium are not significantly different from the total with a normal five year commission-paying period.
2. All insurers pay a very heavy proportion of the total commission in the first year. It is not unusual for total commissions to an agent to amount to from 100 to 120% of one year's premium and for the rate of commission on the first year premium to amount to 60% or 70% for some policies.

It is interesting to note that New York registered companies are by regulation enacted by that state only permitted to pay a maximum of 55% commission in the first year on ordinary business.

3. The high first year commissions paid to agents are justified by the industry on the grounds that these payments relate to the sales and counselling effort involved in completing an application for a policy of life insurance. Proponents of this view suggest that first year commissions should be sufficient to compensate the agent for these efforts.
4. Those in the industry who suggest that the period of paying commission on a sale should be spread over a number of years justify their stance on the grounds of the need for a continuing service to the policyholder.

An acknowledged disadvantage of the commissions system is that under this system salesmen may tend to neglect non-selling activities such as ongoing policy service and may fail to give objective advice. It is further argued that a commission system of remuneration discourages any increase in the provision of services and technical support by life insurance companies

as the added cost of such services cannot be readily attributed to the agent by way of reduced commission, but tend to increase the cost of the product, making it less competitive.

On the other hand, it is argued that, in the sale of life insurance, service and advice to the customer cannot be neglected by either the agent or the insurer without jeopardizing prospects for continuing successful business. To reinforce emphasis on client satisfaction, it is usual for part of the commission to be deferred to future years of payment and for such renewal commissions to be dependent upon the policy remaining in force year after year.

### *Vesting of Commissions on Termination*

While the deferral of commissions to later years perhaps encourages ongoing service by the agent, it creates a problem in the industry in regard to the payment of future commissions in the event of termination of the agent's contractual agreement with the insurer.

Most companies provide in their agents' agreements for vesting of commissions of renewal premiums on termination of employment under certain restricted circumstances. Individual insurers have established their own particular conditions but most would provide for several but not necessarily all of the following considerations:

- termination is due to the agent's death;
- agent has a certain minimum number of years experience with the company;
- agent has exceeded minimum production requirements;
- termination was not for agent's breach of his contract;
- agent was terminated by the company;
- termination was due to the agent retiring.

Frequently insurers make a reduction for collection services for premiums received after the agent's termination.

On occasion, insurers may provide for alternative benefits to the payment of commissions on termination. This may take the form, for example, of life insurance. Some companies restrict the credit for commissions on renewal premiums to the number of years after termination equivalent to the number of years that the agent was associated with the company.

### *Service Commissions*

Some companies pay a service commission in addition to the basic sales commission. The service commission is paid over the premium-paying period of the policy generally after a certain minimum period that the policy has been in force. The minimum period is commonly two years but some insurers defer payment of a service commission for the entire period up to ten years that the commission is paid on the original sale. As an alternative to a



service commission, some companies include a service commission type of remuneration in their bonus provisions as discussed below with the service commission portion of the bonus applying throughout the entire premium-paying period.

1. Rates of service commission range from 1 to 2% of the total of the agent's renewal premiums.
2. Service commissions are most common in agent's group insurance remuneration plans. In these circumstances the service commission is usually paid in the second through the tenth year although some companies will pay a service commission for as long as the policy is in force. Service commissions on group insurance contracts range from a very small percentage of the annual premium for large groups to as much as 15% of the annual premium for smaller groups.

### *Bonuses*

Most bonus arrangements, including supplementary commission payments other than the basic sales commission are designed by insurers to compensate agents for keeping coverage in force, that is, to limit policy lapsation. Most insurers have bonus arrangements that relate to business written during the preceding three years, the years of highest potential lapse. Frequently, companies also pay bonuses over the full premium-paying periods of policies as an encouragement to keep business in force and to provide continuing policyholder service.

Insurers use a number of different bases for their bonus calculations but all relate in some general way to the production volume of the agent adjusted for terminated or lapsed policies. Some insurers use as their volume base, insurance in force, others use number of policies or first year premiums and still others use commissions earned. Generally the rate of bonus is on an ascending scale with higher rates for higher net volumes.

Some insurers take into account other considerations in their bonus calculations including such matters as the quality of the agent's total business; the period over which policy premiums have been fully paid; the duration of the policy premium-paying period; the agent's length of service with the company; and, whether the agent is provided office space by the insurer.

### *Commission Adjustments*

Adjustments are made to commissions paid to agents under a number of circumstances.

1. Nearly all agents' contracts with insurers stipulate that earned commissions are conditional on the policy remaining in force for a certain minimum period of time. If the policy lapses before the end of the minimum period, a commission chargeback is made to the agent. The chargeback

is normally a declining percentage of the first year commission depending upon the length of time the policy is in force and varies by insurer, for example, 21, 24, 36 or 120 months.

2. Many companies stop paying commission to agents on a policy if the policyholder has exercised a waiver of premium rider because of disability. While the practice of stopping the payment of commissions on renewal premiums is general, some companies also make an adjustment of commissions previously paid to agents on these policies.
3. Likewise, many companies invoke commission adjustment rules when a policyholder exercises the automatic non-forfeiture provision in a policy. As in the case of a policyholder exercising a waiver of premium rider, commission adjustments are generally made by insurers on the renewal commission that would otherwise be paid to the agent but some companies also make an adjustment of commissions previously paid to the agent.
4. Commission adjustments are also made by the majority of life insurers when a policyholder converts his policy to a reduced paid-up policy.

In each of these latter three instances, if the first year commission is properly related to the effort involved in the sale of a policy, then it would seem unfair to apply commission chargebacks in any or all of these circumstances.

5. The vast majority of insurers carrying on business in Ontario apply commission chargeback rules on in-house replacements.

Insurers variously define a replacement as a policy which is terminated and on which premiums will no longer be paid, within a specified period before or after the issue of a new policy. The specified period used by insurers varies from 3 months to 12 months before or after the issue of a new policy.

Most insurers stipulate that when a policy is designated as a replacement policy under these rules, the commission adjustments will limit the amount by which the new premium exceeds the old premium on a year by year basis. Some companies apply the commission adjustment only to the first year premium on the replacement policy while others apply the adjustment to a portion or all of the normal commission-paying period.

The period over which commission adjustments are applied on replacement policies varies from company to company, but it is common for commission adjustments on replacements to be applied 10 to 15 years after the issue of the original policy and the Committee understands that some companies apply commission adjustments to *all* in-house replacements regardless of the length of time the replaced policy has been in force.

The Committee understands that a few companies have stopped making commission adjustments on in-house replacements on the grounds that the replacement is good for the policyholder and hence the agent should not be penalized for providing sound advice to the policyholder. These insurers also feel that in-house replacements should be treated in the same manner as out-of-house replacements for commission purposes.

### *Remuneration on Additional Premiums*

Additional premiums may be of two types, those associated with the riders attached to basic policies and those associated with rating the basic policy for a substandard medical, occupational, avocational, aviation or morals/habit risk.

1. In most cases agents receive commissions on the rider premium at the same rate as on the basic insurance policy. The only general exception to this practice relates to various types of term insurance riders, that is, family income, mortgage protection and the like, in which case agents' commissions are calculated at the rates that would be applicable to the term coverage if it had been purchased alone which rates are normally lower than the rates of commission on whole life policies.
2. The practice with regard to commissions to agents on the extra premiums for rated policies varies from company to company. A few companies do not pay any commission on the extra premium for a rated policy; other insurers pay one-half of the normal commission rate applicable to the basic policy; the majority of companies, however, pay commissions at the same rate as for the standard coverage purchased.

### *New Agent Financial Support*

Most companies provide some type of financial support to new agents in addition to the normal commission and bonus remuneration. Support is provided over a defined period and is usually subject to certain conditions. The duration of support can range from 12 months to 120 weeks to 48 months. Support programs may require the agent to complete various training requirements, meet certain minimum production or sales levels, or record and report on work activity, to remain eligible for support.

There are a number of methods used to determine the amount of agent support including:

- business written by the agent,
- applications submitted by the agent,
- minimum income level,
- manager's discretion.

A minimum income level may be a predetermined amount or it may be fixed for the duration of support by the manager with reference to the agent's fi-



nancial needs, previous income levels and the manager's perception of the agent's ability to sell. A predetermined amount may be level for the duration of support or it may decline each month. Some companies permit their managers to use their own discretion and change the amount of support at any time during the support period based on an agent's financial needs. The amount of support may be a direct function of business actually written or there may be no relationship between the two.

During the agent support program, normal commissions and bonuses earned are usually offset against any support payments. Payment of commissions and bonuses earned in excess of support payments are deferred by some insurers for the duration of the support program. These insurers stipulate that an agent would not receive any settlement payments on termination during the probationary period.

## **2. Agent Remuneration—Annuities**

### *Type of Annuity*

The present method of remunerating life insurance agents for annuity sales is different for each basic type of annuity—fixed premium deferred annuities, variable premium deferred annuities and single premium immediate annuities.

1. While agent remuneration for fixed premium deferred annuities is based on a commission rate schedule, there is a much greater variety in the commission-paying periods for annuities than for life insurance products. Commissions for fixed premium annuities are paid by insurers either over two, four, five or ten years or in some cases for the entire premium-paying period of the plan.
2. Commission rates on fixed premium deferred annuities are in some cases related to the length of the premium-paying period.
3. Commission rates vary widely depending upon the length of the commission-paying period. Commissions as high as 60% of the first premium are paid on annuities where the commission-paying period is two years. On the other hand, commissions as low as  $\frac{1}{2}\%$  are paid on premiums if the commission-paying period extends for the full premium-paying period of the annuity.
4. The second and third year commission rates on fixed premium deferred annuities vary from  $\frac{1}{2}\%$  to 25% and for subsequent years from  $\frac{1}{2}\%$  to 7% depending upon the duration of the commission-paying period.
5. Commissions on variable premium deferred annuities are paid at fixed rates on the annuity premiums as they are received. The rates may vary with the size of the premium in any one year or with the accumulated total premiums received over the life of the annuity. Commission rates vary from  $\frac{1}{2}\%$  to 3.5%.



6. Commissions on single premium immediate annuities are calculated as a percentage of the premium received. The commission is paid in total in the first year and the rates vary from  $\frac{1}{2}\%$  to 3% of the premium.

#### *Vesting of Commissions on Termination*

No special provisions are made concerning the vesting of commissions on annuities; the same terms regarding vesting as applied to commissions on life insurance premiums are applied by insurers to commissions on annuity premiums.

#### *Bonuses*

The practice in the industry varies from company to company regarding the inclusion of annuities in volume calculations for bonus purposes. Some companies include annuities in their calculations, other do not. Where annuities are included in bonus calculations, factors are specified to convert annuity premiums or payment amounts to the basis considered to be equivalent to life insurance products.

#### *Commission Adjustments on Policy Replacements*

Commission adjustments are not generally applied in the case of annuities replaced by another annuity.

#### *Remuneration on Additional Premiums*

On occasion, immediate annuities may be issued on a substandard basis for severe medical conditions. In these cases the rating is reflected in increased annuity payments rather than in the premium. Since the premium is not affected there is no impact on the agent's remuneration.

#### *New Agent Financial Support*

Any commissions earned by new agents on annuity sales are taken into account by insurers in the same way as commissions on life insurance sales in determining the amount of support provided to the agent. Most companies also take annuity sales into account in determining whether the agent has met his minimum production requirements for remaining in the support program.

### **3. Broker Remuneration—Life and Annuity Products**

Most insurers have "broker" remuneration plans for compensating organizations wherein a number of agents are carrying on business jointly. In general, the method of remunerating brokers is identical with the method of remunerating an agent of an insurer. Where differences do exist they are generally designed to recognize that the broker's business is expected to be a

continuing one and that the broker provides for many of its own office services.

The minor differences in the methods of remunerating brokers and agents may be reflected in the basis on which renewal commissions are paid to brokers, for example, on the basis of production volume; the period over which renewal commissions are paid; and, some modification of the commission rates based on the basic insurance coverage. In addition brokers do not normally receive bonuses based on the quality of their business or that are related to persistency factors. Finally, it is not usual for there to be restrictions on vesting of commissions due to brokers.

## **C. THE COMMITTEE'S OBSERVATIONS AND RECOMMENDATIONS**

The following observations and recommendations are based on the Committee's review in this Chapter of the methods used by life insurers in this Province for compensating their agents for the sale of life insurance policies. A number of matters related to the compensation system for life agents have come to the Committee's attention and are addressed in turn in this section.

### **1. Commission Consistency**

For some time, the insurance industry has acknowledged that many consumers consider that the basis of remunerating agents and in particular the rates of commission paid on various types of policies can bias agents to the detriment of the consumer.

The industry has recognized that most controversial are the larger commissions paid by some companies to agents selling whole life rather than term insurance. The Committee has found little in consistent patterns in comparing the commission amounts and rates paid on whole life and term policies. Where differences were found in commissions paid on these two types of life insurance, the maximum difference in remuneration for whole life policies over term policies ranged from 10% to 40%.

In an effort to provide direction to the industry in light of criticism of the commission structure, the CLIA has published a recommendation for its member companies which, including its preamble, reads as follows:

#### ***“Foreward***

For many years consumer advocates and media critics have claimed that agents may be influenced in their advice to clients by the commission return on one contract of a company as opposed to another contract of the same company. A number of committees over the years tried to define commission consistency or neutrality and to develop guidelines to effect it. Finally, the Joint CLIA-LUAC Committee on Marketing

and the Committee on Individual Insurance developed a set of recommendations that was approved by Council on April 10, 1979.

The recommendations were:

1. Companies should over a period of time move to make their compensation schedules and practices as simple and as internally consistent as possible. For example:
  - (a) Differences in product design necessitating differences in compensation should be clear cut and capable of rationalization to agents and consumers.
  - (b) Where similar products are offered by a company, particularly if they are offered in the same market, compensation scales should be as similar as possible.
  - (c) Compensation scales for otherwise identical products should not differ on the basis of whether they are:
    - (i) issued on a participating or non-participating basis,
    - (ii) issued as a term policy or a term rider, or
    - (iii) registered versus non-registered.
2. The commission rates for level-premium, level-benefit, longer term contracts and whole life contracts should be approximately the same.
3. Published compensation scales must not be altered in order to change premium rate or policy benefits on a specific case."

In much the same vein, LUAC in its presentation to the Committee made the following comments:

### ***"Commission Consistency***

*What is It?* The terminology "commission consistency" means that commission schedules for life insurance and annuity contracts should be maintained by each insurer on a basis which is consistent among all contracts it issues after taking into consideration the relevant factors such as premium payment period and expected duration of the contract so that (a) there shall be no unfair discrimination among policyowners, and (b) life insurance agents will not be placed in an unfair position where their motives could be open to suspicion.

*LUAC Policy.* As early as 1971 LUAC, in a report prepared by its Remuneration Committee, adopted the following policy with regard to "Commission Schedules":

"Since it is in the public interest to market life insurance on the basis of needs, commission schedules within a company should be based as nearly as possible on the principle of actuarial neutrality (now described as commission consistency). This is desirable to

avoid discrimination among policyowners and to avoid placing the agents in a position where their motives are suspect.”

The above recommendation regarding commission consistency was made in the spirit of the judicial principle that “not only should justice be done, but justice should appear to be done”.

*Industry Support.* It has been a long struggle but LUAC is encouraged to note that one or two major insurers have recently moved to establish the concept of commission consistency throughout their own marketing operations. Furthermore, there are indications that the CLIA will endorse the principle of commission consistency and recommend it to their member companies. LUAC hopes this movement will gain momentum as it is clearly in the public interest and the interests of the life insurance business.”

The Committee finds that there is no precise definition of commission consistency or commissions based on actuarial neutrality. It appears, however, that as the insurance industry is structured in Canada today efforts to attain any significant degree of commission consistency can be accomplished only by individual companies striving for consistent remuneration to agents for each of the coverages offered. It appears also that the prime responsibility for developing the concept within each company would of necessity rest with the actuary who, in determining the premiums for each policy, would be required, in addition to applying appropriate standards of consistency to the factors of mortality, investment income and operating expenses, to use appropriate standards of consistency for remunerating agents, by commissions or otherwise, in setting premiums.

- 12.1 The Committee concludes that commission consistency is a matter requiring significant attention by the life insurance industry in order for the industry to meet its public interest responsibilities. The Committee encourages the life insurance industry to strive for actuarial consistency in the payment of commissions.

To demonstrate that each insurance company is striving for this objective, the Committee recommends that the actuary’s annual certificate be amended to include reference to the extent to which the company has applied actuarial consistency in commissions in the premiums for its products.

## **2. Disclosure of Commissions**

The Committee, in Chapter 9, concluded that the prospective policyholder should be made aware, at the point of sale, of the price he pays for life insurance. An integral part of that price is the commission paid to the agent. It has been proposed by some critics of the industry that disclosure of commission income should therefore be required of a life insurance agent when selling life insurance.



Disclosure of the commission payable on a policy does not, however, provide the prospective policyholder with a full appreciation of the total cost of his life insurance policy. Rather, it focuses attention on a component of cost and could be misleading in some circumstances, particularly when used to compare life insurance costs among policies or companies.

The Committee recommends, as outlined in Chapter 9, a comprehensive, mandatory system of cost disclosure. The Committee recommends that, within that system, there be disclosure at the point of sale of the Company Retention Index as a summary cost index for the policy being sold. The Company Retention Index is an indicator of the total proportion of premiums retained by the company over the lifetime of the policy for expenses and profit. Included as part of the total retention are all acquisition costs including commissions paid by the policyholder through his premium contributions.

12.2 The Committee reaffirms its previous recommendations with respect to a comprehensive, mandatory system of cost disclosure for life insurance policies, as an approach to informing consumers about the cost of their policies that is preferable to disclosure of the commissions paid to the agent.

The Committee nevertheless encourages life insurance agents to disclose to prospective policyholders upon their request the commission payable to the agent for the policy being sold.

### **3. Fee for Service**

The charging of fees as an alternative to the compensation of agents by life insurers appears to be prohibited under Section 388(b)(viii) of The Insurance Act, which states that a “deceptive act or practice” includes “any charge by a person for a premium allowance or fee other than as stipulated in a contract of insurance upon which a sales commission is payable to such a person”. LUAC in its submission to the Committee stated that, although the intention of this subsection is unclear, it had been assured by a previous Superintendent of Insurance that such interpretation as to prohibit charging of fees was not intended.

LUAC states that “charging of fees has become a well established practice for many years on the part of a number of life insurance agents. The practice has grown out of obvious need for the services which support such fees. There are a number of situations not anticipated when the traditional commission system was established and these have given rise to the need to charge a fee.” LUAC lists these situations as including:

- the designing and continued servicing of employee benefits;
- advanced estate planning;
- retirement planning; and

- special requests to review existing insurance portfolios or an individual's financial affairs.

LUAC therefore recommends that:

- “A life insurance agent should be permitted to charge a reasonable fee for services pursuant to a prior agreement between the agent and the client provided such procedure does not contravene any law or constitute unauthorized practice of another profession.”
- “Section 388(b)(viii) of The Insurance Act should be amended to clarify that a life insurance agent is not precluded from charging a fee for services which go beyond the normal negotiation of insurance and where there is prior agreement with the recipient of such services.”

A particular danger that the Committee sees in this proposal is that fees for service may be charged for service which should be provided in the course of earning commission income, thereby adding to the cost of insurance. One method of resolving the concern that fees could be “stacked” on top of commissions is to permit and encourage fees to be offset against any commissions payable for negotiation of a contract of insurance. It would appear, from the Committee's discussions with witnesses, particularly in the group insurance business, that it is already frequent practice for fees to be offset against commissions in negotiating group insurance contracts, generally upon prior negotiation with the prospective policyholder.

The Committee believes that prohibition of the charging of fees precludes the ability of consumers to pay for special services which certain life insurance agents are skilled in providing and it is clearly contrary to current practice in the industry. The Committee concludes as follows.

- 12.3 The Committee concludes that life insurance agents should be permitted to charge a reasonable fee for services which go beyond the normal negotiation of insurance and where there is agreement with the recipient of such services. The Committee concludes that such fees or an appropriate part of such fees should ordinarily be offset against commissions payable to the agent when such services result in negotiation of a contract of life insurance and payment of commission to the agent.

The Committee recommends that Section 388(b)(viii) of The Insurance Act should be amended to clarify that a life insurance agent is not precluded from charging a fee for services under the preceding conditions specified by the Committee.

#### **4. Rebating of Commissions**

##### *The Current Provision in Statute*

Section 356(2) of The Insurance Act prohibits rebating of commissions by insurers or agents to the policyholder. Section 356(2) reads as follows:

“No insurer, and no officer, employee or agent thereof, and no broker, shall directly or indirectly make or attempt to make an agreement as to the premium to be paid for a policy other than as set forth in the policy, or pay, allow or give, or offer or agree to pay, allow or give, a rebate of the whole or part of the premium stipulated by the policy, or any other consideration or thing of value intended to be in the nature of a rebate of premium, to any person insured or applying for insurance in respect of life, person or property in Ontario, and an insurer or other person who contravenes this subsection is guilty of an offence.”

It is noteworthy that this Section of the Act does not prohibit a rebate being paid by an agent to another agent.

This section of the Act is said to permit avoidance of the section by means of advance negotiation. LUAC has brought this matter to the Committee's attention, by stating in its submission that:

“The section describes the offence as a rebate of part or all of the premium “stipulated by the policy” or the making of any agreement as to the premium to be paid “other than as set forth in the policy”. This wording presents a wide open invitation to avoid the section by the simple expedient of negotiating the rebate ahead of time so that the reduced premium will be the actual premium “stipulated” or “set forth” in the policy.”

The Committee has not had any direct evidence presented with respect to the extent of avoidance of the “anti-rebate” provision in the Act by means of prior negotiation of a rebate. Nevertheless, the Committee observes that the nature of group life insurance negotiations and the practice of offsetting fees against commissions in group insurance programs appear to make that sector of the life insurance business susceptible to rebating by prior negotiation. That is, some agents may fail to recover the fee portion of the commission from the policyholder, in effect reducing the premium payable by that policyholder.

#### *Arguments for Review of the Current “Anti-Rebate” Provision*

It has been argued that “anti-rebate” laws inhibit agents from competing on a “price” basis with one another. They make it illegal for an agent to try to decrease the price for his service, even in circumstances where his only service is to transmit an application of insurance. That is, agents cannot compete against other agents on the basis of commissions, thereby posing no competitive challenge to the current “level” of commissions in the industry. Such laws are said to inhibit productivity increases as agents are unable to decrease the price for their service in the hope of increasing volume. As a result there is said to be less incentive for agent efficiency in the marketing of life insurance.

On the other hand, it is argued that rebating, whatever its effects on



price competition, results in unfair discrimination against policyowners who pay the standard rate. When a premium, which is reduced because of reduction or elimination of the commission factor, is offered to one person or a group of persons and not to other policyowners, it is argued that the expense associated with the service that is essential to each contract will be shifted to the other policyowners.

LUAC in its submission before the Committee has argued that rebating is a practice that can be described as “unfair discrimination between individuals of the same class and of the same expectation of life” with regard to rates, dividends, terms or conditions of a life insurance or annuity contract. As such it would appear to be an unfair or deceptive act or practice as described under Section 388(b)(ii) of The Insurance Act.

Accordingly, LUAC recommends for the Committee’s consideration that:

- “The issuing of a life insurance policy for a reduced rate or reduced policy values by virtue of a reduction or elimination of the loading for commissions should be prohibited on the ground of unfair discrimination unless the insurer is prepared to issue all its contracts on the same basis.”
- “Section 356(2) of the Insurance Act regarding rebating should be amended to prevent avoidance of the section by the simple expedient of adjusting the premium or policy values before the policy is issued.”

The Committee’s conclusions on the topic of rebating of commissions are tied with its previous recommendation that life insurance companies strive to achieve actuarial consistency in the payment of commissions. Given efforts of the industry to achieve actuarial consistency in commission payments, the Committee can agree that the rebating of commissions appears to be a form of unfair discrimination. In these circumstances the Committee concludes that rebating of commissions be prohibited and that this prohibition be reinforced in The Insurance Act.

12.4 The Committee recommends that the practice of issuing of a life insurance policy for a reduced premium rate or increased policy values by virtue of a reduction or elimination of the loading for commissions be examined carefully by the Superintendent as a possible form of unfair discrimination. Such examination should be conducted in the context of industry efforts to achieve actuarial consistency in commissions payable on life insurance policies. The Committee recommends that if the rebating of commissions is found to be unfairly discriminatory, then Section 356(2) of The Insurance Act should be amended to prevent avoidance of the section by the simple expedient of adjusting the premium or policy values before the policy is issued.



## **5. Policy Service and Deferral of Commissions**

Industry representatives argue that, in the sale of life insurance, service and advice to the customer cannot be neglected by either the agent or the insurer without jeopardizing prospects for continuing successful business. To reinforce emphasis on client satisfaction, it is usual for part of the commission to be deferred to future years of payment and for such renewal commissions to be dependent upon the policy remaining in force year after year. As seen in the description of remuneration methods, the current practice in Ontario is for companies to defer payment of from 25% to substantially over that percentage of commissions to renewal years. On this subject CLIA has stated:

“It is common for half the commission to be deferred to future years and payment of such commission is dependent upon the policy’s remaining in force and being serviced by the agent.”

The Committee finds that deferral of commissions is not necessarily an effective means of providing incentive for ongoing policy service. Given the industry record on agent turnover, policy lapse and replacement, it may be said that deferral of commissions is not sufficient on its own to foster improved policy service on an ongoing basis.

An alternative means to encourage ongoing policy service might be to pay the agent service fees, persistency bonuses or the like over the period in which the policy stays in force. This practice is already common with respect to sales of group life insurance contracts and is frequent in the sale of individual policies.

12.5 The Committee encourages the industry to pay commission or preferably fees for ongoing service or persistency, if appropriate to the policy sold, and to separate such commissions or fees from the payment of the original sales commission.

## **6. Deferral of Commission Costs for Purposes of Calculating Cash Values**

Despite the deferral by most companies of payment of commissions over a period of some years, many companies still pay a significant proportion of the full commission in the first year. This practice results in a heavy first year expense load on the policy which slows cash value build-up and reduces return to the policyholder. To avoid this problem,

12.6 The Committee recommends that insurers be encouraged to charge only a portion of the commission in the first year against the cash value of the policy. Under the recently revised methods of calculating actuarial reserves, insurers have already developed formulae for deferring acquisition costs for financial reporting purposes. This same practice should be applied to the calculation of cash values, in a consistent

manner for all policyholders. Where early lapse or termination of policies results, adjustment rules could be applied which would charge back against the amount of cash value payable, the unrecovered portions of the first-year premiums. No adjustments should be required for long-term policyholders.

## **7. Vesting of Commissions**

While, as previously noted, the deferral of commissions to later years perhaps encourages ongoing service by the agent, it creates a problem in the industry in regard to the payment of future commissions in the event of termination of the agent's contractual agreement with the insurer.

LUAC, in setting out "guidelines for the development of a life agent's compensation plan", has recommended that an agent's contract provide for immediate vesting of all future commissions (but not service fees) in the following situations:

- in the event of the agent's death or permanent disability
- in the event of termination of contract for any other reason after a reasonable period of service, say five years, provided the agent remains in the life insurance business.

LUAC states that a few, but relatively few, companies have adopted the LUAC position on vesting.

12.7 The Committee recognizes that the decision by insurers about whether or not to vest commissions is of major concern to life insurance agents, but believes that this is a matter to be resolved by the participants in the life insurance industry rather than a matter for government intervention.

## **8. Commission Adjustments**

Life insurance companies make commission adjustments in certain circumstances. These have been found to include:

- policy lapse before the end of a minimum period
- policy replacement
- premiums waived because of disability
- premiums paid by automatic policy loan
- conversion of the policy to a reduced paid-up policy.

In such circumstances a commission chargeback may be made to the agent so that commissions earned but deferred to future years may not be paid even if the policy remains in force. In some cases, commissions already paid may be credited back to the insurer by the agent.

The Committee recognizes the rationale for commission adjustments in the circumstance of early policy lapse, before the end of a minimum period

of time. However, the Committee is less convinced about the fairness to the agent of commission chargebacks in the other circumstances listed above.

The Committee notes that in the matter of policy replacements, commission adjustments generally restrict the amount of commissionable premium on the new policy to the amount by which the new premium exceeds the old; in many cases, the first year commission on the replacement policy is reduced by the amount of or a portion of the amount of the commission paid on the old policy. These commission adjustment rules may discourage agents from making "in-house" replacements, although such policy replacements may be in the policyowner's interest. A joint CLIA and LUAC Committee on replacement has studied this problem and recommended:

"member companies are requested to practice a similarity of treatment with respect to field compensation of both in-house and out-of-house replacements."

- 12.8 The Committee recommends that life insurance companies undertake to employ a similarity of treatment of life insurance agents with respect to both in-house and out-of-house replacements of life insurance policies beyond an early lapse period, that period to be specified uniformly in application to all companies.

The Committee further believes that the agent should expect uniform treatment with respect to compensation for the sales and servicing of life insurance policies, no matter what options or benefits are exercised under the policy.

- 12.9 The Committee recommends that life insurance companies undertake to eliminate commission chargebacks in the circumstances where a waiver of premium rider is exercised because of disability of the policyholder and in situations related to the exercise of non-forfeiture options under the policy, except in circumstances of defined early lapse of the policy.

## **9. Remuneration on Additional Premiums**

Additional premiums are associated with riders attached to basic policies or with policies rated as substandard. Company policies with respect to paying commissions on these extra premiums vary considerably.

In general commissions are paid on the extra premiums at the same rate as on the basic policy for most riders, with the exception of various types of term riders which may pay commissions at lower rates similar to term policies themselves. For rated policies, commissions on the extra premiums range from zero to the same rate as for the basic policy.

It has been suggested to the Committee that no commissions should be paid on the extra premiums associated with riders or rated policies, as the

sales effort involved in such situations may not be greater than that required for the sale of the basic policy and hence no extra compensation should be paid.

However the Committee recognizes that some extra effort may be involved in the sale and service of riders on policies as well as in the sale of substandard policies. Hence the Committee concludes that insurers be permitted to pay extra commission if and when required by the marketing effort involved in selling riders or related policies. The Committee nevertheless encourages companies to reduce or eliminate commissions on "extra premiums" wherever possible.





## PART VI

PROFIT EMERGENCE, PROFIT DISTRIBUTION  
AND OTHER MATTERS



## CHAPTER 13

### Profit Emergence, Profit Distribution, and Other Matters

#### A. INTRODUCTION

Preceding Parts of this Report have dealt with the implications of mortality and the compensation of sales persons on the cost of life insurance to consumers. However, there are many other aspects of the organization and operations of the life insurance business which ultimately affect the price policyholders must pay for the products the industry provides. In this Part a broad spectrum of other matters are covered under the following headings:

- Profit emergence in the life insurance industry;
- Profit distribution in the life insurance industry;
- Other organization and operating matters.

#### B. PROFIT EMERGENCE IN THE LIFE INSURANCE INDUSTRY

Basically, life insurance involves a promise to pay an amount of money at some definite but unknown future time in the event of an occurrence relating to a human life in return for a premium(s) established at the time the contract is made. The premium, therefore, must be based on assumptions concerning future mortality, investment and expense experience. The profitability of a particular group of policies cannot be known with certainty until all of the policies have terminated because mortality, investment earnings and expenses many years in the future cannot be accurately predicted. Some life insurance contracts may continue in force for 50 years or even longer.

Apparent profits or losses will emerge from year to year as actual experience under the policies differs from that anticipated when the premium was calculated. To determine whether these are true profits or losses, a company must consider and differentiate between fluctuations that may be occurring year by year and trends that appear different from those anticipated. Judgment is involved in deciding whether apparent profits that are emerging are real or whether they should be set aside to meet future contingencies. Because life insurance companies must always be looking to the future in order to ensure that benefits to policyholders will be paid when they become due, any discussion of the emergence of profits in the life insurance business must begin with a review of solvency requirements and the role of the actuary, particularly concerning the valuation of actuarial liabilities. Following comment on these two subjects, other matters affecting the profitability of life insurance companies are discussed.

##### 1. Solvency Regulation

The Federal and Provincial regulatory authorities have from the beginning recognized their role in solvency regulation as:



- providing protection to the consumer in regard to future claims, and
- providing a form of solvency regulation to prevent, as far as practical, any default.

As discussed in Chapter 3, the Federal Department of Insurance now concerns itself almost exclusively with the financial soundness of Canadian companies incorporated federally and non-Canadian companies carrying on life insurance business in Canada. In addition to other matters, the Ontario Department of Insurance concerns itself with the solvency of all companies licensed to do business in Ontario. In practice, the Ontario Superintendent discharges his responsibility as set out in section 15(1) of The Insurance Act as follows:

1. For Canadian companies incorporated federally and non-Canadian companies he adopts the inspection of the federal government and relies on the federal Superintendent's staff to carry out such reviews and examinations as it deems appropriate. While the Ontario Superintendent and his staff may conduct an overview of the returns of these companies, effectively they rely on the work of others and "usually receive a certificate of solvency" that a review and examination has been completed satisfactorily.
2. For Quebec and British Columbia incorporated companies he follows a similar practice and relies on the Superintendents in these provinces to carry out a satisfactory review and examination. Presently there are seven such companies carrying on business in Ontario.
3. For Ontario incorporated companies he and his staff carry out their own review and examination.
4. For companies incorporated provincially other than in Quebec and British Columbia, he follows the same review procedures as for Ontario incorporated companies. At present there is only one such company licensed to write life insurance in Ontario.

The main thrust of the Federal Insurance Acts is to ensure that sufficient assets are maintained to meet obligations to policyholders. In the past, therefore, various sections of the two Federal Acts set out types, qualities and amounts of the investments companies are permitted to make and minimum standards for the valuation of life insurance contracts. As explained more fully later, amendments to the Canadian and British Insurance Companies Act in 1977 have made some changes in asset valuation and income reporting and significant changes in the methods of determining actuarial liabilities.

The Ontario Insurance Act also contains various sections and regulations concerning the categories, qualities and amounts of the investments

companies are permitted to make and also defines minimum standards for the valuation of life insurance contracts. No amendments have been made to The Insurance Act of the Province to reflect the changes that were made in 1977 in the federal legislation concerning the methods of determining actuarial liabilities and other asset valuation and income reporting changes. However, in response to a request for his comments on the necessary changes to Ontario legislation to incorporate accounting standards and reserve calculations made to federal legislation, the Ontario Superintendent replied as follows:

“Necessary changes to The Corporations Act and The Insurance Act have been drafted. These changes will result in the Ontario Act being effectively the same as the Federal Acts. It is proposed to recommend these changes early in 1980 to be effective for 1980 fiscal year.

Working through the Association of the Superintendents of Insurance, general agreement appears to have been obtained with all the provinces with the exception of Quebec as to the changes to be made to legislation and the adoption of new reporting forms. In essence, the Federal legislation and reporting forms will be adopted. It is generally felt by the Superintendents that adoption of the Federal changes in principal is required in order that Provincial insurers will not operate at a disadvantage. Most Superintendents feel that it would be simpler and more efficient for both the insurers and the supervisors if the Federal changes were adopted virtually without change. Quebec felt that it should vary the Federal format and has passed the necessary legislation. No significant problems are envisaged on an inter-provincial basis.

In essence, the changes to the legislation will loosen slightly the restrictions on the operations of insurers and should reduce the impact on insurers of violent swings in the market values of securities.”

The Committee now understands that the changes to The Corporations Act and The Insurance Act have been redrafted to incorporate some minor revisions but it is possible that the proposed amendments may not be submitted to the Legislature for its consideration until the fall session of this year. As the Superintendent noted before the Committee the proposed changes “loosen slightly the restrictions on the operations of insurers”. In particular, regarding the calculation of actuarial reserves, it is proposed that companies instead of being required, unless specifically exempted, to value reserves in accordance with rates and other criteria set out in Schedules to the Act will now use rates, tables and assumptions that in the opinion of the valuation actuary “are appropriate to the circumstances of the insurer” and “are acceptable to the Superintendent”.

Further, regarding the changes in the method of valuing and reporting of investments, the enabling sections in The Insurance Act have been re-

drafted referring to regulations that are intended to bring the Ontario practice into line with the provisions in the federal Act. The regulations, however, have not yet been drafted.

The implications of the changes in the federal legislation, as noted, are dealt with in some detail later in this chapter.

Presently, the staff in the Ontario Superintendent's Office examine the affairs of four life insurers and six fraternal societies incorporated in Ontario and one life insurer incorporated in New Brunswick. In addition, the staff "try and cover" the mutual benefits societies with more than 300 members and a few of the smaller societies. The examiners ensure that the companies are conforming to the Act and regulations as they apply to investments and their valuation. However, the examiners rely on the certificate of the valuation actuary concerning the "actuarial reserves". Examiners also review the practices of insurers regarding the retention of individual risks with the intent of seeing that no company retains a risk greater than 2% of its equity. Ontario examiners use as well a series of "early warning tests" to attempt to identify companies that may warrant further attention. These tests include reviews of:

- changes in surplus
- net gain to total income
- commission and expenses to premium income
- investment yield
- changes in premium income
- change in product mix
- change in asset mix
- change in reserving ratios.

### *The Committee's Observations and Conclusions*

The record of both the federal and provincial authorities is one that reflects the success with which the "solvency requirements" have been monitored and controlled. Despite the choice of products available to the consumer, the insured remains assured that in at least one respect his choice of an insurance product will not be unwise—he is assured by the government that his claim will be paid.

The Committee is concerned however that in the discharge of the Superintendent's responsibilities under Section 15(1) of The Insurance Act that reliance on the adequacy of the review and the examination conducted by the Superintendents and staff in other jurisdictions is incomplete without the formality of the receipt of a certificate from these jurisdictions that a review and examination has been completed satisfactorily.

- 13.1 The Committee recommends that amendments be made to Section 15(1) of The Insurance Act to formalize the procedures to be followed



when the Superintendent of Insurance adopts the inspection of another jurisdiction to review and examine the affairs of a life insurance company licensed to carry on business in Ontario. These procedures should include completion of a certificate to be received by the Superintendent in a form suitable to him that would outline the extent of the review and examination, whether the results of the review and examination were satisfactory and, if not, the specific deficiencies identified.

The Committee's concern regarding the review and examination of insurer solvency by other jurisdictions was compounded as it appreciated that the basis of the review and examination of the federal Superintendent for the years 1978 and 1979 of Canadian companies incorporated federally and non-Canadian companies were based on amendments to the Federal Acts which have not as yet been reflected in The Insurance Act of Ontario.

The Committee appreciates the difficulties created by the division of responsibility for matters relating to life insurance in Canada and understands some of the problems that are involved in arriving at a consensus among all interested parties. However, in matters as important as were reflected in the 1977 amendments to the Federal Acts concerning asset valuations and income reporting and in particular the significant changes in the method of determining actuarial liabilities and reserves, the Committee would have expected that special efforts would have been made to involve the Departments of Insurance of at least the Provinces where most of the head offices of life insurers reside. Indeed, the Committee might have anticipated that efforts would have been made to have the implementation of the amendments in the federal legislation carried out concurrent with legislative sanction in at least some of the Provinces.

In the future:

- 13.2 The Committee urges the Superintendent of Insurance of the Province to encourage the closer cooperation of his fellow provincial Superintendents and the federal Superintendent when matters relating to the solvency of insurers, in which all jurisdictions are jointly concerned, are under consideration for possible revision by any jurisdiction.

## **2. Responsibility of the Actuary to the Regulatory Authorities**

In connection with the valuation of actuarial liabilities, both the federal and provincial authorities rely on valuation actuaries. The federal Insurance Acts require each registered company transacting life insurance business to appoint a valuation actuary who must be, except under extremely limited circumstances, a FCIA. These Acts require companies to file annual statements with the Department of Insurance accompanied by a report of the valuation actuary with respect to the reserves for life policies stating that the assumptions used in calculating the reserves are "appropriate" to the



circumstances of the company and the policies in force, the reserves have been calculated in accordance with the Act and make good and sufficient provisions for all unmatured obligations guaranteed under the terms of the policies in force.

Similarly, The Insurance Act of Ontario requires that the annual statements of life insurance companies be accompanied by a certificate from an actuary stating that the reserves are not less than those required by law and that they make good and sufficient provision for unmatured obligations.

It is worthy of note that the Federal and Ontario pension legislation, as well as similar legislation in a number of other Provinces also require that supervised pension plans be reviewed periodically by an actuary and that reports thereon be prepared by him. The federal Income Tax Act also refers to an actuary stipulating that an approval for special payments for past service to a pension plan must be accompanied by an actuarial report before it will be approved.

### 3. Statement of Income of a Life Insurance Organization

A simplistic summary of a statement of income of a company in the life insurance business provides a useful point of reference for a review of the emergence of profits and for a discussion of the various sources of income and of the expenses of a typical life insurance operation and therefore the net cost of life insurance to the public of Ontario. Such a simplified summary statement of income might show:

Income:		
Premium income	XXX	
Investment income (net)	XXX	
Other income	<u>XXX</u>	
	XXX	
Benefits and expenses:		
Benefits paid to policyholders and beneficiaries	XXX	
Additions to actuarial liabilities	<u>XXX</u>	
	XXX	
Operating expenses	XXX	
Premium taxes	<u>XXX</u>	
		XXX
Income before dividends to policyholders and income tax		XXX
Dividends to participating policyholders		<u>XXX</u>
		XXX
Income taxes		<u>XXX</u>
Net income		<u>XXX</u>

Premium income and benefits paid require no detailed comment; they have been covered adequately in previous portions of the Report. Premium income would consist of premiums earned on all life insurance policies and annuities. Benefits paid would consist of payments for death and disability claims, amounts paid on the surrender of policies, annuity payments, and interest paid to policyholders.

#### **4. Additions to Actuarial Liabilities**

In addition to the benefits paid out by a company during the year, a company must ensure that for the business it has in force it makes adequate provision for the amounts to be paid to policyholders in the future. For a life insurance company carrying on business in Ontario and Canada this usually means an addition to its actuarial reserves or liabilities.

The method of determining adequate actuarial reserves is "part science and part art" as previously discussed and is the responsibility of the valuation actuary for each company. Further discussion about the role of the valuation actuary and the methods and assumptions he uses to make some of these calculations follows in Section D of this Chapter.

#### **5. Investment and Investment Income**

One of the key elements in determining premium costs is the rate of return earned by insurers on the investments they hold. In general the insurance industry has been conservative in its investment philosophy, concerned with safety of principal and with consistency of a moderate rate of return. This section of the chapter deals with the reasons for, and implications of, the insurance industry adopting and generally maintaining this philosophy. A brief discussion outlines the sources of the industry's very significant investment portfolio, followed by an historical recount of the development of the industry's investment philosophy and by certain data and comments concerning the assets held by insurers at the end of 1978. The Committee's conclusions and recommendations related to investments complete the section.

##### *Source and Role of Investments*

There are four main sources of the investment funds of life insurance companies:

- premiums collected in early years under level premium plans that are in excess of those needed to pay claims and expenses for those years;
- the accumulation of funds under annuity contracts and pension plans;
- funds left with the companies under policy settlement options; and
- funds left with the companies under dividend options.

The prime purpose of the resulting asset pool is to guarantee future pol-

icy benefit payments to policyholders and beneficiaries. The second purpose is to earn investment income to help reduce the cost of insurance and annuity premiums. Finally, these funds provide pools of capital for Canada's development.

### *Historical Development*

Life insurance was introduced into Canada in the 1840's initially by British companies and later by American firms. A few Canadian companies commenced operations about this time as well. There was no government regulation. The Canadian companies generally offered more attractive premiums because they invested in more speculative bonds than their foreign counterparts. This policy, however, led to some near disasters as some companies concentrated their investments in particular industries, including savings banks, where performance tended to be volatile. As a consequence, Canadian companies generally changed their philosophy and developed diversified investment portfolios. They also decided to stay out of the saving bank business which, of course, later proved to be a very lucrative field for other financial institutions.

By the time of confederation, the insurance industry in Canada was dominated by 12 foreign companies. There were only 3 Canadian companies of any significance. In general, companies were conservative in their investments, concerned with the long-term nature of their business and their ability to remain solvent.

In 1868, 1875 and 1877 the Canadian Government passed legislation to supervise the insurance industry. This action was taken to foster confidence in the Canadian industry by establishing a Superintendent of Insurance to supervise and review the affairs of the companies. Much of the impetus for legislation resulted from the failures and insolvencies of insurance companies in Britain. In essence the Acts provided that there must be assets maintained in Canada to provide for all actuarial liabilities in Canada. The assets were to be of a type that would guarantee solvency. The first federal Superintendent of Insurance, J. B. Cherriman, expressed a principle that still is accepted today.

"The directors are only trustees or agents for the disposition of the money entrusted to them by the ensured, and the ensured has the right to know what is done with the money so entrusted."

This precept is the basis of the federal Department of Insurance's emphasis on the solvency of insurers and the publication of annual reports concerning the financial affairs of insurers registered under the Canadian and British Insurance Companies Act and the Foreign Insurance Companies Act.

The emphasis on trusteeship and solvency combined with publicity, both by the government and the industry, fostered a conservative attitude

toward investments. The government took further actions in 1899 and 1910 to regulate the types of investments life insurers might make. The regulations were the first attempt at defining the corporate securities in which the industry could invest. The definition of acceptable securities was based on the ability of the corporation involved to meet certain profitability standards. The 1899 legislation permitted investment in a broad range of investments, with no specific limits. The 1910 legislation was more specific and called for tougher profitability standards before investments could be made. However, neither series of amendments dealt with the amount of the various types of investments that could be held in a portfolio.

In general the industry stayed away from equity investments because of the possible volatile nature of such investments. However, the largest insurance company in Canada was an exception to the rule. By the late 1920s it held over 50% of its asset portfolio in equities. As a result of the difficulties experienced by this company in the stock market crash of 1929 the government reacted in 1932 by placing a ceiling on equity investments at 15% of the assets of insurance companies. This has since been modified and insurance companies can now hold 25% of their general fund assets in common stocks.

In 1948 the regulations were loosened further to permit certain "basket investments" of a more speculative nature. The percentage of assets in the "basket clause" has been increased periodically since 1948 to the present limit of 7% of the book value of general fund assets for loans and investments in other than real estate and leaseholds.

In summary, the tendency initially was for Canadian companies to be more speculative in investments than foreign firms and after some bad experiences to become conservative. In keeping with this general philosophy, the government introduced legislation defining more or less all types of permissible investments for insurers and, in the process, introduced more stringent regulations from time to time. Since 1940, these regulations have gradually become more flexible. There is no evidence that regulations have, at any time, inhibited the investment policies of life insurers since the Committee has been told that the industry has never made any serious attempt to have them relaxed.

The attitude of the regulatory authorities and, therefore, the insurance industry in this country can probably be summarized best by reference to the 1962 Submission to the Royal Commission on Banking and Finance by the Federal Superintendent of Insurance. In his submission, Mr. MacGregor expressed approval of the views on investments enunciated by the first Superintendent in 1875 as follows:

"On the question of investments, his recommendations were equally sound. He said it must be observed that a life company is not in the position of a commercial institution where a high rate of interest can be



made with a certain amount of risk. The all essential principle of a life company is security and no speculative employment of the funds entrusted to it can be sanctioned.”

He also indicated his approval of a portion of the Royal Commission Report of 1906 with the following comment:

“The Commission has stated very fully its conviction that all accumulated funds belonging to policyholders are essentially trust funds. It necessarily results that permissible investments should be confined within such boundaries as may be appropriately delimited for the investment of that class of funds. Speculative investments ought to be excluded.”

Later, Mr. MacGregor pointed out in his submission that, by risky investments, he had in mind common stocks subject to wide fluctuations in price, indicating as well, that his view on investments had wide support in the industry:

“many life insurance companies do not feel that common stocks are a suitable investment medium for life insurance funds . . . Certainly, if a life insurance company does invest heavily in common stock, it exposes itself to the wide fluctuation of the market and if it should suffer embarrassment as a consequence, the criticism of policyholders would be loud, sharp and prolonged. It is impossible to satisfy all critics and the first duty of life companies is to their policyholders.”

The conclusion of the Superintendent was that “life insurance companies hold money in trust for policyholders that this means that they should ensure that liabilities can be met in current dollars, and that as a consequence, securities subject to wide fluctuations should be avoided.” Provisions contained in both the federal and provincial statutes regarding suitable investments for life insurance companies continue to reflect this general philosophy.

### *Authorized Investments*

Set out below is a summary of authorized investments as prescribed in the present Canadian and British Insurance Companies Act:

- (i) Bonds of or guaranteed by the governments of Canada or any province thereof and other countries or subdivisions in which the company does business.
- (ii) Bonds of or guaranteed by a municipality in Canada or any other country in which the company is carrying on business.
- (iii) Corporation bonds fully secured by mortgage on property.
- (iv) Equipment trust certificates issued for the purchase of transportation

equipment for use on railways or public highways by a Canadian or United States corporation.

- (v) Debentures of a corporation whose common shares or preferred shares qualify for investment, subject to a test of total indebtedness at the time of investment, or which has had satisfactory earnings for at least the preceding five years.
- (vi) Guaranteed investment certificates issued by a Canadian trust corporation whose common shares or preferred shares qualify for investment.
- (vii) Preferred shares of a corporation which has paid a dividend at least equal to the specified annual rate upon all of its preferred shares in each of the preceding five years or whose common shares qualify for investment.
- (viii) Common shares of a corporation which has either paid a dividend upon its common shares or had earnings available for the payment of a dividend upon its common shares of at least four percent of the stated value of the shares in four of the preceding five years, including the immediate preceding year.
- (ix) Mortgage loans on real estate or leaseholds not to exceed 75% of the value of such real estate or leaseholds, or loans in excess of this limit if the excess is guaranteed or insured by an agency of government or is insured by a policy of mortgage insurance issued by a registered insurer.
- (x) Real estate or leaseholds for the production of income, provided a lease is made to a government or subdivision thereof, or to a corporation whose preferred shares or common shares qualify for investment, and the lease requires repayment of at least 85% of the amount invested within the period of the lease but not exceeding thirty years.
- (xi) Real estate or leaseholds for the production of income, provided the revenue therefrom in each of the last three years would be sufficient if continued to repay at least 85% of the amount invested over the economic lifetime of the improvements to the real estate or leaseholds but not exceeding forty years.
- (xii) Real estate for the company's own use.
- (xiii) Loans to policyholders on the security of their policies.

Under a "basket clause", certain amounts of life insurance company funds may be invested in assets not specifically authorized by legislation. Up to 7% of the book value of the general fund (i.e., non-segregated fund) assets of the company may be in real estate or leaseholds not meeting the specific eligibility test above provided that no more than 2% (within the 7%

limit) is other than for the production of income. As well, up to 7% may be in other classes of investments not meeting the stated qualitative requirements. This clause does not, however, permit investments that are specifically prohibited nor does it override the quantitative restrictions on certain investments that are described below.

Other federal statutory limitations on a Canadian life insurance company's investments include the following:

(i) Company stock

1. The book value of a company's general fund (i.e. non-segregated fund) investments in common stock may not exceed 25% of the book value of the general fund assets.
2. No insurance company may invest its life insurance funds in the stock of any other corporation transacting the business of life insurance in Canada.
3. No insurance company may purchase more than 30% of the common stock of any one corporation, except when establishing certain kinds of subsidiaries or affiliates as follows:
  - (a) foreign life insurance corporations;
  - (b) corporations providing advisory, management, or sales distribution services in respect of segregated fund policies;
  - (c) Canadian non-life insurance corporations;
  - (d) corporations for acquisition, improvement, leasing or managing of real estate;
  - (e) corporations offering participation in an investment portfolio (mutual funds);
  - (f) corporations providing those in (e) with advisory management or sales distribution services;
  - (g) with approval of the Minister, any corporation carrying on business reasonably ancillary to the business of insurance. (Among business considered to be reasonably ancillary to life insurance are data processing companies and para-medical examination clinics.)

(ii) Real estate for the production of income

1. The book value of a company's general fund investments in real estate may not exceed 15% of the book value of the general fund assets.
2. The total investment in any one parcel of real estate which specifically qualifies as an eligible investment must not exceed four percent of the book value of the company's assets.
3. The limit per parcel purchased under the "basket provision" is two percent.

(iii) No insurance company may invest in a corporation that is a substantial shareholder of the company, a corporation in which a company director

or officer or his spouse or children has a significant direct or indirect interest or a corporation in which a substantial shareholder of the company has a significant direct or indirect interest.

- (iv) No investment may be made in any security on which payment of principal or interest is in default.

### *Elements of Current Philosophy*

In its submissions to the Committee, the industry drew particular attention to the interrelationship between the industry's investment philosophy and the nature of the associated liability. The long-term nature of life insurance contracts and their guaranteed benefits differentiated life insurance from other financial institutions. Insurance companies look for investments with a fixed payback, for security of principal and a rate of return consistent with the safety of the ultimate repayment. At the same time insurance companies must consider liquidity to meet maturing obligations and diversity of portfolios to protect against isolated bad experience. Other investment criteria include marketability of assets and geographic dispersion of investments. The industry recognizes a moral, in some cases legal, responsibility to invest geographically. The matter of regional investment has been of increasing concern in recent years in Canada as some companies have been accused of not investing locally the premiums of policyholders of a particular area of the country.

### *Assets of Life Insurance Companies*

Information provided to the federal and provincial Superintendents of Insurance are summarized in annual reports issued by the Superintendents. The significant data concerning investments as contained in these reports have been reviewed, together with a recapitulation prepared by the CLIA, a summary of which is set out in Table 1. This information indicates that the assets of life insurance companies held on behalf of Canadian policyholders and valued at book value, totalled approximately \$33.9 billion at the end of 1978, as follows:

TABLE 1  
ASSETS OF LIFE INSURANCE COMPANIES IN CANADA<sup>1</sup>—1978  
(\$ millions)

	Pooled Funds		Segregated Funds		Total Amount
	Amount	Percent of Total	Amount	Percent of Total	
Bonds	\$10,961	37.4%	\$1,445	31.5%	\$12,406
Mortgages	11,525	39.3	1,730	37.7	13,255
Stocks	2,658	9.1	1,036	22.6	3,694
Real Estate	1,534	5.2	15	.3	1,549
Policy Loans	1,443	4.9	—	—	1,443
Cash	251	.9	187	4.0	438
Other	962	3.2	179	3.9	1,141
Total	<u>\$29,334</u>	<u>100.0%</u>	<u>\$4,592</u>	<u>100.0%</u>	<u>\$33,926</u>

1. Excludes assets held by fraternal and mutual benefit societies.

Source: CLIA.



In preparing reports to the Superintendents of Insurance, life companies do *not* consolidate the operations of their subsidiaries. Rather, the companies record their investments in these subsidiaries at original cost, adjusted for the pro rata share of the profits or losses of each subsidiary since acquisition. While precise figures are not readily available, the carrying value of the investments in subsidiaries of the companies included in Table 1 would be approximately \$410 million and is included in the total of Pooled Funds—Other Assets.

Without information concerning the nature and amounts of the underlying assets held by the subsidiaries, it is impossible to obtain a satisfactory understanding of the investment holdings of life insurers. This is particularly true regarding the industry's investment in, and control of, real estate properties and development in Canada. But the concern is applicable as well to the significance of the industry's investments in other assets through other subsidiaries. A perspective of the magnitude of the life insurance industry's investments in shares of subsidiary companies may be obtained from the 1978 Report of the Superintendent of Insurance for Canada which includes a listing of "Investments of Life Insurance Companies". This summary is reproduced in Appendix J.

Subject to the foregoing limitations concerning the investment in and assets held by subsidiaries, the following comments concerning each of the major categories of assets held by life insurers at the end of 1978 relate to the data set out in Table 1.

### *Bonds*

The relative importance of bond investments is apparent. These investments best reflect the historical preference of the industry for safety of principal, possibly at the expense of higher returns. The insurance industry total holdings in bonds in 1978 account for approximately 30% of Canadian corporate bonds outstanding, 16% of municipal bonds, 11% of provincial bonds and 8% of Canadian Government securities.

### *Mortgages*

Investment in mortgages reflects the life insurance companies' investment philosophy of attempting to match their investments with the long term nature of their liabilities. Mortgages mirror life insurers' annuity business and provide a stable return with security. According to the CLIA, life insurance companies financed 13% of all mortgages in Canada as at the end of 1978. Of this amount the industry indicated that 58% were for residential financing. The following table summarizes the industry's investments in mortgages by region as compared to life insurance in force in various regions of the country.

**TABLE 2**  
**COMPARISON OF MORTGAGES HELD BY INSURANCE COMPANIES**  
**BY REGION WITH TOTAL LIFE INSURANCE IN FORCE BY**  
**REGION—1978**

Region/Province	Life Insurance In Force	Mortgages
Maritimes	6%	3%
Quebec	24	17
Ontario	40	50
Prairies	17	18
British Columbia	12	11
Other, Territories, etc.	1	1
	<u>100%</u>	<u>100%</u>

*Source:* Adapted from Report of Superintendent of Insurance for Canada, 1978.

### *Stocks*

Section 63(7) of The Canadian and British Insurance Companies Act, limits the investments of life insurance companies in common stocks to 25% of the book value of their general fund assets. Other sections outline the profitability standards a corporation must attain before life insurers can invest in its stock, either preferred or common. It is apparent that the industry as a whole has not tested the 25% limit on its investment in common stocks. While the investment in equities has steadily increased over the years from 5% in 1920 to 11% of total invested assets in 1978, the main reason for the change has been the introduction of variable rate contracts.

There are many reasons why the industry has been reluctant to invest in equities as compared to other alternatives. First, investment in equities is not seen to be consistent with the long term guaranteed nature of the industry's liabilities. Their products emphasize low risk guaranteed values and dividend stability and the perceived volatility of the stock market is not consistent with this theme. Second, in determining premiums, calculating actuarial reserves and setting dividend policies, the industry looks for a stable return. Equities generally are not seen as meeting these criteria.

A factor that may increase the industry's investments in stocks in the future is the change in federal income tax law in 1977 which abolished the tax on dividends in the hands of insurance companies. Another factor which has already had an impact on the industry's investment in stocks has been the segregated fund concept and, to the extent that it continues to gain market acceptance, it should provide more funds for investment in equities. The trend toward secure equity stocks may be influenced further by competition in the industry. Some companies have introduced new products and lines of business that involve more flexibility and initiative in their investment strategies.

## *Real Estate*

It has been impractical for the Committee to obtain an appreciation of the life insurance industry's investment and holdings in real estate. Not only are real estate subsidiaries not consolidated and, therefore, excluded from the total of \$1,549 million shown as the industry's investment in real estate in Table 1, but the real estate which is included in Table 1 is valued at book value, which likely bears little relation to its real or market value. The industry did indicate to the Committee that while the majority of its real estate investments were in commercial property, 31% were in residential, mainly multi-family dwellings.

## *Policy Loans and Other Assets*

These assets include outstanding loans to policyholders secured by the cash surrender value of policies and other miscellaneous assets, receivables, and temporary cash balances. As noted earlier, the industry's investment in subsidiaries is included in the total of other assets at a value of approximately \$410 million being the cost of the investment adjusted for the pro rata share of any profits or losses since the shares in the subsidiary were acquired.

## *Segregated Assets*

A life insurance company may maintain one or more segregated funds for the investment of premiums from individual variable life insurance and annuity contracts and in the group field for the investment of pension plan contributions. Segregated fund type contracts were introduced in 1960 and have grown to more than \$4.6 billion by the end of 1978. As reflected in Table 1, the tendency is for insurers to invest a higher proportion of these funds in equities: 22.6% at the end of 1978 for segregated funds compared with 9.1% for pooled funds, with a consequent lower proportion in bonds and mortgages.

## *Investment Income and Rate of Return*

There is a lack of precise information concerning the rate of return earned by the life insurance industry on its investments. As discussed, it is impractical to get a clear picture of the industry's complete investment holdings. Further, data are not regularly summarized of the income from investments for the industry as a whole and distinguishing between the portions applicable to segregated funds and pooled funds. The information, however, that is available covering a substantial portion of the industry as reported by the federal Superintendent of Insurance indicates that there has been a favourable trend in the rate of return on investments in recent years. An extract from the 1978 report of the federal Superintendent follows:

“The average net rate of investment income earned by Canadian com-

panies on their life insurance funds was 8.5% and the range was from a high of 10.6% to a low of 4.1%.

The following table shows comparable figures:

Year	Rate of Interest Earned
1955	4.2%
1965	5.6
1969	6.1
1970	6.2
1971	6.3
1972	6.6
1973	6.8
1974	7.1
1975	7.4
1976	7.7
1977	8.1
1978	8.5

#### *The Investment Implications of the 1977 Amendments to the Canadian and British Insurance Companies Act*

Reference has been made throughout this Report to the 1977 amendments to the Canadian and British Insurance Companies Act as they apply to asset valuation and income reporting. The comments which follow deal very briefly with those changes as they relate to the investments of life insurers.

The thrust of the amendments was to remove the possibility of arbitrary adjustments of income or surplus by the use of trading or write-off practices. The statutory reporting requirements in effect until the end of 1977 required that profits and losses realized on the sale of investments be excluded from income and included as an adjustment of surplus. Therefore, income and surplus could be influenced by choosing securities to be sold and the timing of those sales. Some felt that some security sales which could have been made and which in the long-term would have benefited a company may have been deferred because of their potential effect on the current year's income and surplus. The new regulations effective for 1978 and subsequent years required a spreading of profits and losses against income over a period of several years. The aim of these amendments has been to improve the method of accounting for securities and security transactions so that accounting treatment alone will not create incentives to trade or not to trade. The spreading of realized profits and losses for bonds and the combined realized and unrealized profits on stocks over a number of years will tie together investment income determination and investment valuation.

The particular changes included in the 1977 amendments as they pertain to various types of investment may be summarized as follows:



## ***Bonds and Mortgages***

The basis of determining carrying values of bonds and mortgages is set out in regulations under the Act. These regulations stipulate that securities with fixed term and fixed income are to be carried at amortized cost to indicate that premiums or discounts on purchase represent a reflection of the market interest rate at the date of purchase. Therefore the premium or discount will be amortized against income as an adjustment of the stated or coupon rate of interest. Further, profits or losses realized on the sale of these securities will be recorded as an adjustment of the total carrying value and amortized over the period from the date of the sale to the date of maturity, not to exceed 20 years. This treatment reflects the fact that transactions in long term investments are usually made to improve yields on a long term basis.

## ***Stocks***

The new regulations require that equities be carried on the balance sheet at an adjusted value representing cost plus or minus a bulk adjustment to reflect a portion of the difference between cost and current market value. Profits or losses on the sale of equities are not taken into account at the time of the transaction, instead, they are to be combined in the bulk adjustment as part of the carrying value of the equities and securities in such a way that both realized and unrealized profits or losses are merged and taken into income over a period of years starting in 1978. The adjustment toward market value each year is stipulated at 7% of the difference between the adjusted book value and year end market value with the current year's market value adjustment brought into income.

## ***Real Estate***

The regulations still permit real estate to be carried at depreciated original cost with an option that other values, market or appraised values, may be used on approval of the Superintendent. Since market values are difficult to determine, it is understood that most companies carry their real estate investments at depreciated original cost.

## ***The Committee's Observations and Conclusions***

If the industry is to fulfil its role in the financial protection system, the products it provides will have to be responsive to consumer needs and changing economic conditions and the management of policyholders' funds will have to be efficient. Among other matters, this will necessitate a continual review of investment policies to ensure, within the constraints of liquidity and other requirements to meet obligations to policyholders, that insurers obtain the best possible return on their investments. Insurers will need to be

particularly alert, innovative and efficient in all areas of their activities, including their investment policies and practices in providing benefits to annuitants to help alleviate the problem of inflation.

On a matter related to the investment practices of life insurers, the Committee has already commented in recommendation 8.4 in Chapter 8 that insurers should adhere to the “portfolio method” of dividend distribution. In addition, the Committee will comment at the end of this Chapter, in its general observations and conclusions, on the aspect of the information available concerning the industry’s investment activities and, in particular, on the importance of full disclosure to the public of the use that is being made of such a large pool of investment capital as the industry controls.

Beyond these two matters, the Committee’s observations and conclusions on other matters relating to the investment practices of life insurance follow.

The Committee is duly cognizant of the excellent safety record of the life insurance industry in Ontario and Canada. The fact that the conservative income policies of the companies has contributed to this safety record cannot be denied. On the other hand, the Committee as a whole is of the opinion that the industry’s investment philosophy may have been too conservative and that the industry should perhaps take advantage of a wider spectrum of investment opportunities.

- 13.3 The Committee congratulates the life insurance industry on its excellent safety record as demonstrated by its ability to satisfy all policyholders’ claims when due and acknowledges that this record is at least in part a reflection of the success of the management of its investments.
- 13.4 The Committee questions, however, the continuing appropriateness of the insurance industry’s investment philosophy as being ultraconservative and suggests that the industry be encouraged to take advantage of a broader spectrum of investment opportunities available to it in Canada and of the greater margins available with these investments. The Committee encourages the industry in particular to participate more actively in real estate development and new energy programs.
- 13.5 The Committee believes that there is a continuing need for approved investments for insurance companies to be set out in statute. The Committee notes as well that life insurers have rarely, if ever, challenged as being too restrictive any of the limitations contained in statute. Nevertheless, the Committee proposes that the requirements as set out in the Act should be reviewed on a regular basis to ensure that they provide the flexibility necessary for insurers to take advantage of changing investment opportunities and participate fully in Canada’s growth opportunities.

## 6. Other Income

There are no detailed industry-wide data available concerning the sources and amounts of the miscellaneous income of life insurance companies. Included would be a portion of the amounts the industry receives for investment and actuarial counselling services, rental and other income from the use of computers and other assets and the profits on the sale of assets. In total, other income accounts for about 1% of the revenue of the life insurance industry.

Many life insurers have subsidiaries that provide investment counselling, computer and other services. Since data on the operations of these subsidiaries are not consolidated in reports to the Superintendents, it is impractical to obtain an appreciation of the extent of the life insurance industry's involvement in these ancillary activities.

## 7. Operating Efficiency

It is apparent that one of the factors likely to result in lower net premiums to policyholders is the efficiency of operating performance of insurers. Unfortunately, it is impractical to obtain any precise appreciation of the portion of the policyholders' premiums that are absorbed in operating expenses. The industry indicated only that in 1978 operating expenses accounted for approximately 14.4% of the total of the premiums, investment and other income the industry received, but neither the industry nor the Superintendent of Insurance publish meaningful data concerning the details of expenses, trends in expenses or criteria that might aid consumers to measure the operating efficiency or to assess the performance either of the industry as a whole or individual companies in relation to the premiums they pay.

This situation is not unique to the operations of insurers in Canada. Indeed, the leadership in any area of expense analyses that has been provided to the industry in North America has come from the Canadian Institute of Actuaries. Some years ago the CIA established an Expense Sub-Committee which developed methodology for determining the expected expenses for various groups of insurance companies against which the actual expenses of each group of companies and each company in each group might be compared annually. The reports of the Expense Sub-Committee of the CIA, are of some use to those in the industry to assist in the maintenance of a reasonable cost level in proportion to each company's activity. The concept developed by the CIA has been used since by LIMRA as a basis of developing similar data for U.S. insurers.

In sum, beyond the information developed by the CIA which is of some value to insurers but of no value to policyholders, there are no meaningful data published by the industry or the Superintendent of Insurance to aid consumers to assess the operating efficiency of life insurers in Canada.



## 8. Taxes and Life Insurance Companies

Taxation is a direct cost to life insurance companies and like all costs ultimately borne by the insured as part of the policy premium.

This section looks at the two forms of direct taxation on the life insurance companies:

- income taxes, as charged by the federal and provincial governments, and
- premium taxes, as charged by the provincial governments.

### *Income Tax*

Today, the life insurance industry is subject to federal and provincial income taxes in the same general way as most other industries. However, this situation is relatively new to the life insurance industry in Canada and is the result of significant changes in tax legislation since 1969. These changes have resulted in a two-way increase in costs to life insurers; first, through the direct cost of the taxation and second, through the indirect cost of increased administrative procedures. An overview of the taxation system prior to 1969 and the changes since is set out below.

Prior to 1969, income tax at the normal corporate rate was levied only on the dollar amount transferred to the shareholders' fund in stock companies. These companies were able to control their taxable income by transferring only sufficient amounts to cover the liability for the income tax and shareholders' dividends. The remaining profits could be allocated to a non-participating fund or contingency reserve thus avoiding taxes in the current year.

Mutual companies, not having shareholders, were not subject to income tax, prior to 1969.

The changes brought into effect in 1969 taxed companies on a more equitable basis. Both stock and mutual companies became subject to income tax at normal corporate rates on their income in Canada. An additional tax of 15 percent was levied on the net investment income, subject to various adjustments. The purpose of this additional amount was to tax the benefit provided to the policyholder by way of increased dividends and reduced premiums.

Minor changes were made in income tax legislation in 1972, and in 1978 the 15 percent tax was repealed when the \$1,000 personal investment income deduction was introduced, which negated the rationale for the tax.

At present, life insurance companies are subject to income taxes at normal federal and provincial rates applied against their Canadian income. The taxable income amount for life insurance companies is calculated based on special provisions and regulations specific to the industry.



Where other companies are taxed on a world-wide basis and are allowed credit for foreign taxes paid, life insurance companies, both stock and mutual, are taxed only on income earned in Canada. Insurance premiums and investment income, excluding dividends are treated as income. The companies are allowed deductions for policyholder dividends, increases in actuarial liabilities as prescribed by regulation and an investment reserve of 1.5 percent of the value of bonds, debentures and mortgages similar to that allowed other financial institutions. Life insurance companies are also subject to capital gains taxation rules on the sale of shares and real estate, but the sale of bonds, debentures and mortgages are treated as active income and taxed at normal rates. In essence, both stock and mutual companies are taxed upon their surplus before certain contingency provisions, but after all distributions to policyholders by way of dividends.

In the case of stock companies, in addition to the taxation of the ongoing business, there is another tax liability payable by insurance companies distributing shareholders' dividends out of the pre-1969 earnings on which no tax had originally been paid. These funds had been sheltered in special non-participating insurance reserves which were not taxable prior to 1969. The current tax rate on such distributions is equal to twice the amount of the shareholders' dividend paid.

Generally, fraternal and mutual societies are not taxable if they distribute all earnings back to the members of their organization. Where they are involved in the insurance business, they are taxable only if any surplus is not given back to the policyholders as dividends.

### *Premium Tax*

Premium taxes are a common form of taxing insurance companies around the world. In Canada, the provincial tax authorities levy the tax on premiums, net of policy dividends for life insurance policies which provide death benefits. Annuity premiums are not subject to this form of taxation.

The present rate in all provinces in Canada is 2 percent. This rate has been in effect for many years except for a short period in 1976. In April of 1976, Ontario raised the premium tax on all insurance premiums to 3 percent. This meant that all life insurance companies, including U.S. companies operating in Ontario, were subject to the additional tax. Many American states levied a "retaliatory" premium tax on Canadian companies writing in their state, with the effect the Canadian insurer was no longer price competitive. In response, the Ontario government reduced the premium tax on life insurance premiums back to 2 percent almost immediately.

With the exception of Ontario and Quebec, fraternal and mutual benefit societies are exempt from premium taxes in all Canadian provinces and American states. There is a concern expressed by the fraternal and mutual

benefit societies that funds which could otherwise be used for benevolent purposes are being taxed away. The premium tax paid by fraternal in Ontario in 1977 was approximately \$500,000 or .04% of the amount collected in corporation tax in Ontario. Representations were made to the Select Committee by the Canadian Fraternal Association to the effect that the premium tax on their insurance should be removed.

The Committee agrees and therefore:

- 13.6 The Committee recommends that appropriate changes be made to the taxation legislation of the Province to exempt fraternal and mutual benefit societies from the payment of premium taxes on the life insurance premiums received from their members.

It was also drawn to the Committee's attention that Blue Cross offers health insurance coverage in direct competition with life insurance companies, but is not subject to the 2 percent premium tax. The Committee is to review the entire matter of accident and sickness insurance and related matters in its next Report and will comment further on this subject at that time.

## **C. PROFIT DISTRIBUTION IN THE LIFE INSURANCE INDUSTRY**

The foregoing section dealt briefly with the emergence of profits in the life insurance industry. However, not all profits emerging in a particular year are likely to be distributed. It is the practice in the industry to make additional provisions to cover fluctuations in interest earnings and expenses and changes in life expectancy and to maintain special contingency reserves as well.

### **1. Mutual and Stock Companies**

Determination of the beneficiaries of profits in a life insurance company depends, first, on whether the company is a mutual or a stock company and, second, on formulae designed to see that profits are distributed equitably and reasonably among those entitled to participate in the distribution.

In the case of a mutual company, there are no shareholders. The profits of a mutual life insurance company which are paid out are distributed to the participating policyholders and in effect reduce the original cost of their insurance.

Stock life insurance companies, on the other hand, have shareholders. However, to the extent that these companies may have issued participating policies they are restricted by law as to the amount of the profits from this portion of their business that they may receive.

Both mutual and stock companies may sell non-participating policies.

Any profits arising from this portion of the business would be distributed when paid to the participating policyholders in the case of a mutual company and to the shareholders in a stock company.

## **2. Allocation Procedures in Profit Distribution**

### *Regulatory Authorities' Monitoring Activities*

Life insurance companies are required to maintain separate funds for various segments of their life business, as a minimum, these segments are individual life, individual annuity, group life and group annuity; for their non-life business; and in each case separating their participating and non-participating policyholders' business. A stock company is also required to maintain a separate Shareholders' Fund.

Insurers are required to develop data to support an annual "statement of funds" to present the continuity of each fund, tracing the changes that have taken place during the year, the impact of these changes on the fund at the beginning of the year and the balance of the fund at the end of the year. While premium income, benefits and some expenses are readily allocated among funds, investment income and many costs must be allocated in considerable detail and frequently on the bases of sophisticated formulae. The allocation bases and formulae must be reasonable and consistent; however, since they can be arbitrary in some cases, they leave room for favouring one fund or another. It is therefore important that careful attention be given to the bases of allocation.

An insurance company is required to include in its annual filing with the Superintendent of Insurance schedules concerning each fund it maintains to include details of the continuity of each and the methods, bases and formulae used to allocate all income and expenses among each. Historically, regulatory authorities have been concerned with the allocation priorities to ensure that participating policyholders are credited with their share of profits. Efforts have been made to minimize arbitrary allocations. With the descriptions and schedules included in the annual filing, the Superintendent is provided with an opportunity to review the consistency of procedures and in general their adequacy.

### *Actuary's Role in Allocations*

The role of the actuary is a particularly challenging one. He is responsible not only for determining that adequate provisions are made for actuarial liabilities so that policyholders will be paid in the future, but also for determining the equitable and reasonable distribution of any profits from the participating funds that it is decided may be distributed to the participating policyholders.

In setting dividend scales on participating policies the actuary utilizes



complex formulae based upon the policy design and performance of the company. The basic methodology of the dividend distribution practices of each company is included in the annual filing with the Superintendent of Insurance.

The actual amount of surplus that is distributed is approved by the Board of Directors of each company. The amount of the surplus from the participating funds that may be transferred to the Shareholders' Fund is regulated by statute.

The actuary, in determining policyholder dividends, must address himself to the principles of fairness and equality. Various policyholders purchased policies at times when assumptions as to investment and life expectancy may have been different. These factors must be considered in establishing dividend rates.

In determining dividend levels the actuary is also concerned with what is reasonable as a dividend for the current year. The industry perceives that consumers wish to see dividends rise over time or at least not decrease. In order to help this happen the actuary is inclined to calculate conservative dividend rates so that a significant amount of surplus attributable to participating policyholders is retained for distribution in later years. The surplus is held and invested by the insurance companies.

This free surplus has been the centre of controversy for many years—to whom it belongs and what should be done with it.

“A strict interpretation of an equitable distribution of surplus seems to require that all the surplus as it arises should be allocated to each individual participating policyholder according to the contribution his policy has made to the total surplus. This is the basis on which the contribution method of distributing surplus—probably the most equitable method—rests.”<sup>1</sup>

Insurance companies have withheld distribution of substantial portions of the participating fund surplus in order to allow for all contingencies. Surplus held for the present can be used to ensure that dividend scales are maintained in the future should operating results falter temporarily. More importantly surplus is retained to finance growth.

In an attempt to add insight into this question Robin Leckie, a Canadian actuary, prepared a discussion paper for the Society of Actuaries on the issues surrounding surplus and other actuarial considerations and circulated his paper for discussion to a number of noted actuaries. Mr. Leckie introduced the concept of “target surplus”. This concept centres on formulating a surplus maintenance program that is adequate to finance the expected growth pattern of a company and calls for participating policyholders to

1. Actuarial Practices of Life Insurance—Fisher and Young, page 206.



leave a portion of their surplus in the company to help acquire new business—incidentally providing additional safety for their investment in the company.

Others view excess surplus as money withheld from current and past participating policyholders interest free. From this perspective, any discovery by management of such surplus funds should result in the immediate recognition of an obligation to current policyholders and should not result in the use of these funds to offset the costs of future policyholders who are not yet policyholders.

A Committee on Dividend Philosophy of the Society of Actuaries was appointed on March 1, 1976 with the following terms of reference:

“The purpose of this Committee is (1) to study in depth the underlying actuarial principles and practical problems related to the calculation and illustration of dividends, including related matters and philosophy, and (2) to develop a report on its findings and recommendations.”

The Committee issued an interim report in September 1977 and a further report in September 1979.

The Committee dealt with a number of matters relating to dividend distribution including endorsing the Contribution Principle in Section 2 of its recommendations:

- “2.1 The basic principle of dividend determination is to distribute the divisible surplus among policies in the same proportion as the policies are considered to have contributed to the divisible surplus. This is said to be the Contribution Principle. In a broad sense, the Contribution Principle provides the essential equity implied by participating business.
- 2.2 RECOMMENDATION 2: The use of the Contribution Principle in determining dividends is generally accepted practice. The actuary’s report should include a statement that this principle has been followed. If it has not been followed, the report should explicitly state any deviations and their rationale.”

In matters of detail the Committee of the Society of Actuaries dealt only with mutual life insurance companies indicating that because of the complexities of dividend distribution in stock companies, detailed consideration of that portion of the business was deferred.

The Committee made it clear, however, that:

- “1.3 The determination of the aggregate amount of dividends to be distributed in any year is a decision to be made by Company Management in light of many factors, the most significant being the continuing solvency of the company and its ability to fulfil all contractual obligations. This determination is not the subject of this Recommendation.”

It is clear that it is the management of the company that determines the amount of the dividend to be distributed to participating policyholders. In order to provide a degree of policyholder protection and to ensure some uniformity of dividend practices among companies registered to carry on business in New York State, the New York Insurance Law includes provisions that limit the surplus that may be accumulated over and above all of the reserves and liabilities required or specifically permitted, to an amount not exceeding \$850,000 or 10% of a company's policy reserves and policy liabilities whichever shall be greater.

As at the end of 1978 the liabilities—defined as actuarial reserves, amounts on deposit, provision for dividends and accrued profits to policyholders and provision for experience rating refunds—of Canadian companies incorporated federally for the participating portion of their business were \$14,377 million. The surplus in the fund was shown as appropriated surplus of \$1,020 million and unappropriated surplus of \$1,486 million, for a total of \$2,506 million. For all companies the ratio of unappropriated surplus to liabilities was almost exactly 10%. However, some companies retained unappropriated surplus considerably higher than the average—a number retained surplus equivalent to more than 15% and some almost 25% of their liabilities.

Comparable figures for the non-participating funds of these companies as at December 31, 1978 indicate liabilities of \$9,224 million, appropriated surplus of \$644 million and unappropriated surplus of \$833 million. The ratio of unappropriated surplus to liabilities for the industry was about 9%.

### *The Committee's Observations and Conclusions*

The Committee's review of the matters relating to profit distribution and dividend practices of life insurers, particularly as these matters pertain to participating policyholders, leads it to endorse unanimously the concept of the Contribution Principle of dividend distribution as being the most equitable method of allocating to each individual participating policyholder any surplus arising on the participating portion of the business according to the contribution made by each policy to the total.

- 13.7 The Committee recommends the use of the Contribution Principle in determining dividends to be distributed by life insurance companies as being the most equitable method of dividing surplus among the policies in the same proportion as the policies contributed to the surplus to be distributed.
- 13.8 The Committee further recommends appropriate amendments be made in The Insurance Act to require that the valuation actuary for each insurer be required to include in his annual report that the Contribution Principle has been followed or, if the Contribution Principle has not been followed, a full statement concerning the deviations and their rationale.

With the implementation of these recommendations, the Committee does not see the necessity of stipulating in insurance law, at least for the present, the amount of unappropriated surplus a life insurer may be permitted to retain in a participating fund.

The Committee will defer its further observations and conclusions regarding profit distribution and, in particular, the timing of these distributions until the end of this Chapter when reference is made to a number of general observations and conclusions concerning the management and operations of the life insurance industry in Ontario and Canada. As these later comments pertain to profit distribution, they are made in the general context that:

- life insurance companies and therefore their managers are trustees for the policyholders;
- life insurance management's concerns and judgments should be constantly related to the best interests of policyholders, present and future;
- policyholders and consumers are "entitled to know";
- determining an acceptable level of surplus is difficult, but this does not mean that insurers should not address themselves individually and collectively to the problem;
- inflation is the major problem facing most Canadians and life insurers have an obligation to protect, as far as practical, policyholders from inflation and, in this regard, to give back to participating policyholders either in the form of dividends or extra coverage as much of the surplus as practical arising from the contributions their policies have made to the surplus; and
- the building of surplus in participating funds just for the sake of growth is *not* appropriate.

## **D. RELATED ORGANIZATIONAL AND OPERATING MATTERS**

Reference has been made throughout this Part to changes in reporting of life insurance companies as a result of amendments to the British and Foreign Insurance Companies Act in 1977. The impact of these changes as well as comments on the standardizing of actuarial practices and on mutualization together with a number of observations, conclusions and recommendations of the Committee on these and other general matters are the topics of this section.

### **1. Impact on New Financial Reporting on the Financial Statements of Life Insurance Companies**

#### *History*

The Canadian and British Insurance Companies Act and regulations thereunder as they relate to the solvency of insurance companies are de-



signed to monitor and to ensure the protection of policyholders. In so doing, the accounting practices followed in valuing assets and estimating liabilities have always been much more conservative than those followed under generally accepted accounting principles (GAAP) and have paid very little attention to the determination of income in the generally accepted accounting sense. Indeed, the financial statements of insurance companies whether prepared for shareholders, policyholders or other interested parties have been greatly influenced by the regulatory requirements.

Pressure for change began in the United States in the 1960's to establish a more realistic approach to the financial reporting of life insurance companies. Prompted by the changes in financial reporting in the United States, the Canadian Institute of Chartered Accountants (CICA) prepared a research study on the financial reporting of life insurance companies in 1973. The Canadian Life Insurance Association (CLIA) and the Canadian Institute of Actuaries (CIA) prepared reports in response. After publication of these reports, the Federal Superintendent of Insurance formed an Advisory Committee to study financial reporting for the life insurance industry. Based on the recommendations of this Committee, the Superintendent prepared a report suggesting a basic format for financial statements that would serve both the regulatory requirements related to solvency and generally accepted accounting principles. This was to be accomplished first by preparing financial statements in accordance with GAAP and then by recording the additional reserve requirements necessary for solvency tests as appropriations of retained earnings.

In summary, the Federal Superintendent said:

"The Department is seeking through these proposals to improve the nature of financial reporting by life insurance companies with the objectives of:

- (a) Revising the information shown in the income statement so that it reveals more clearly the profit or loss on an ongoing basis . . . .
- (b) Improving the comparability of one company with another.
- (c) Clarifying the role of the actuary and the auditor concerning the expression of professional opinion as to the adequacy and appropriateness of the actuarial reserves.
- (d) Improving the method of accounting for security transactions so that accounting treatment alone will not create incentives to trade or inhibit trading in securities.
- (e) Finding a way of recognition, in the income accounts, of market appreciation of equity holdings. To improve the reporting of investment income and remove possible unfairness between different generations and policyholders."

The 1977 amendments to the Canadian and British Insurance Companies Act and regulations were designed to implement the Superintendent's proposals.



The major changes introduced by the new legislation to be effective for the 1978 reporting year of life insurance companies and which had the most significant impact on reporting earnings were:

- The use of more appropriate assumptions for calculation of policy contract liabilities.
- A deferral of a large portion of acquisition cost through the reserving method.
- Restatement of assets to amortized cost as at January 1, 1978.
- The spreading of realized capital gains and losses on the sale of bonds and debentures, stocks and mortgages over a period of years.
- The continuous move towards market value for stocks on the balance sheet.
- The recognition of certain assets previously not recognized such as furniture and equipment and agent's debit balances.
- The establishment of an investment reserve to offset asset fluctuations.
- The establishment of the independence of the valuation actuary with special reporting requirements to the Board of Directors and Department of Insurance.

The matter of investments and the valuation of investments was dealt with in Section B of this chapter.

As regards other assets, certain expenditures for items considered assets under GAAP had not been permitted to be reported previously as assets of a life insurance company since their liquidation value in a solvency test was uncertain. Such assets as furniture and fixtures, agent's debit balances and prepaid expenses were, under the conservative solvency approach of the Department of Insurance, expensed in the year purchased or incurred. Now that the statutory annual statements conform more closely to GAAP, proper asset accounts for these items have been established, with depreciation calculated as in most other organizations.

### *Actuarial Reserves*

Very significant changes were reflected in the amendments to the Canadian and British Insurance Companies Act concerning the deferral of acquisition costs and their amortization over the life of a policy and the methods of determining actuarial liabilities. Companies registered under provincial statutes, including Ontario, are still operating under the old minimum reserving requirements but as the Ontario Superintendent noted in his appearance before the Committee, Ontario is proposing to follow the federal lead and amend the Ontario law to bring it into line with the federal requirements. The proposed changes are expected to be submitted to the Legislature during 1980.

As regards deferred acquisition costs, before the amendments to the federal Acts, agent's commissions and similar new business acquisition costs were expensed as incurred by the life insurance companies rather than being matched against premium income over the policy life. Under the amended legislation, deferral of a portion of these expenses is now accomplished by permitting the actuary to deduct, in determining policy reserves, an amount related to unamortized acquisition costs.

Prior to 1978, the Canadian and British Insurance Companies Act also specified a number of restrictions concerning actuarial calculations in the interest of solvency. Mortality tables and maximum interest rates were authorized in a schedule under the Act although the Superintendent could authorize additional tables or increased rates when given evidence that they were appropriate. With the amendment to the Act and regulations, it is now expected that actuarial liabilities will be calculated on a net level premium basis. The amended Act states only in a general way the basis on which reserves are to be calculated. Interest and mortality assumptions are to be "*appropriate*" to the circumstances of the company and the policies in force. Each company will depend on its actuary to determine what constitutes "*appropriate*" or reasonable reserves. As matters presently stand, there is no requirement for consistency among the individual companies although each valuation actuary must justify his assumptions in a report to the Federal Superintendent. Further comment concerning the issue of standardization of methods and assumptions will be made in the next section of this Chapter.

Information provided by the Federal Department of Insurance referred to the impact of the change in the asset and liability valuation rules on the aggregate surplus position of the 59 Canadian life insurance companies and may be summarized as follows:

	\$ (Millions)	%
Surplus released due to:		
(a) Revaluation of invested assets	122	8
(b) Restatement of pre-1978 non-admitted assets	56	4
(c) Restatement of actuarial reserves	<u>1,339</u>	<u>88</u>
Total released to surplus	<u>1,517</u>	<u>100</u>
Allocation of amount released to increase:		
(a) Required appropriation of surplus	415	27
(b) Voluntary appropriation of surplus	575	38
(c) Free surplus	<u>527</u>	<u>35</u>
	<u>1,517</u>	<u>100</u>

The Canadian Life Insurance Association was asked to comment on the

significance of the amounts released to increase surplus and in particular the amounts increasing the free surplus and voluntary appropriations of surplus, a total of more than \$1.1 billion. The CLIA explained that it did not have any position on the matter referring the Committee to its press release of February 2, 1979 as its only official statement on the subject. The release merely outlined in brief the changes in reporting requirements but made no comment on their implications beyond stating:

“The net effect is to achieve a better presentation of assets, liabilities and surplus and a more consistent measurement of income for the year.”

The Federal Superintendent of Insurance included the following comment in his 1978 report in reference to the amount released to surplus:

“Although the amount of surplus released is significant, it is not necessarily indicative that premiums have been excessive nor that the surplus released is necessarily available immediately for distribution in the form of an increase in dividends to participating policyholders. Some of the surplus released constitutes safety margins that were formerly included in the actuarial reserves. It must be remembered that the amount of actuarial reserves, the largest liability item in a life insurance company’s financial statement, depends on the judgment of the company’s actuary as respects future experience in regard to mortality, investment income and operating costs. Consequently, some safety margins are necessary, be they included in the actuarial reserves as was the case in the past, or reported as surplus as tends to be the situation since the implementation of the new actuarial reserving system.”

In a further effort to gain an understanding of the amount released to surplus because of the 1977 amendments, the Office of the Federal Superintendent was requested to analyze the \$1,517 million by fund. From the information provided in response to this request a very close approximation has been developed which indicates that, of the total, \$861 million was applicable to participating funds and \$656 to non-participating funds.

Further reference is made to the release of surplus resulting from the 1977 amendments to the Canadian and British Insurance Companies Act in the Committee’s general observations and conclusions at the end of the Chapter. Before that, however, this section concludes with a discussion of standardizing actuarial practices.

## **2. Standardizing Actuarial Practices**

As discussed above, the Canadian Institute of Actuaries has participated with the Canadian Institute of Chartered Accountants, the Canadian Life Insurance Association and the Superintendent of Insurance for Canada in various studies that have resulted in amendments to the Canadian and

British Insurance Companies Act. These amendments which were effective for the 1978 fiscal years for companies to which the Act applied made significant changes in the methods of determining actuarial reserves for reporting purposes. The new Act and regulations thereunder, rather than attempting to define the methods by which actuarial reserve will be calculated, now states only in a general way the basis on which they are to be determined. Mortality and interest assumptions are to be appropriate to the circumstances of the company and the policies in force.

As a consequence of these amendments, the valuation actuary has greater freedom in the choice of valuation assumptions and in the deferral of acquisition expenses when calculating actuarial reserves. Stated in another way, however, each company will depend on its actuary to determine what constitutes appropriate reserves with the possibility that there could be considerable difference of opinion among the actuarial profession as to what constitutes "appropriate". Recognizing the problem, the Council of the CIA asked a Sub-Committee to develop a set of recommendations for the profession that would provide guidance in the use of the greater freedom and establish principles relating to the actuarial aspects of the new financial reporting system. The more significant matters covered in the guidelines published by the Council may be summarized as follows:

Guidelines regarding assumptions:

- Assumptions should be appropriate giving due regard to actual experience for the company and industry and should be periodically tested.
- Appropriate provision should be made for adverse deviations but the cumulative effect should be reasonable with no provision for abnormal adverse deviations.
- Investment rates should be established considering projected rate of return on investments and capital gains net of taxes, responsiveness of dividend policies, contingencies for adverse deviations and continuing inflationary factors.

Guidelines regarding valuation methods:

- Any acceptable actuarial method may be utilized in determining the policy benefit liability although under statute the net level premium method must be used in order to highlight any deviation from this methodology.
- In calculating the net level premium definitions are specified to determine valuation premiums.

Guidelines regarding the Actuary's Report:

- Report formats are suggested highlighting the appropriateness of the reserves.



In general the guidelines provide for a degree of flexibility in establishing assumptions based upon actual experience and professional judgments. As noted, the valuation actuary must detail and justify to the Superintendent of Insurance the assumptions he adopts.

With the amendments that were made to the British and Canadian Insurance Companies Act, the observation was made by Mr. T. B. Suttie, then President of the Canadian Institute of Actuaries that:

“The actuary faces totally new circumstances in moving from an environment of fairly rigidly defined assumptions into an area of judgement. And, of course, he must justify every assumption he makes.”

He then went on to say that the CIA guidelines are intended as an aid to the actuaries faced with the flexible and fairly open-ended approach in the new rules.

“As time goes on, the CIA guidelines will probably be refined when the practical problems in valuation procedures come to light as actuaries work with the new rules.”

“The guidelines are not the whole answer since they will be helpful to the company actuary who already has over-all judgement in making valuation decisions, but totally inadequate for the inexperienced practitioner.”

The CIA has established a Committee of Financial Reporting to which an actuary may refer specific questions:

“Much emphasis is placed on professional discretion in that the actuary must certify that his assumptions are appropriate.”

It is generally acknowledged that much progress has been made towards having life insurance financial statements conform to GAAP. However, some have expressed the view that if generally accepted accounting principles are to be applied in this area to make comparisons among companies in the industry possible, it will be necessary for the industry or the actuarial profession to adopt a more or less uniform basis of reserve determination based on conservative—but not ultra-conservative—assumptions. Any additional provision for “contingency reserves” under this concept would be treated as appropriated surplus rather than as a charge against income.

Concern and possibly some differences of opinion continue to exist among various members of the Canadian Institute of Actuaries regarding the CIA’s specific responsibilities in setting out standards or uniform criteria for its members to follow.

### *Standardization and Pension Plans*

The concept of actuaries regarding development of standardized actuar-

ial practices is not confined to matters related to the assumptions, methodology and reports on actuarial liabilities and reserves, required for the corporate financial reporting purposes of the life insurance companies. Many, both within and outside the actuarial profession, have been concerned also about the importance of standardizing actuarial practices and procedures as they pertain to individual pension plans and the reporting requirements for those plans.

In a more general vein, Mr. Suttie commented on one aspect of the problem when he expressed the view that the life insurance industry still has a large credibility problem with clients—when two actuaries look at the same employee pension plan and employee data and produce actuarial cost estimates that vary by as much as 50% or even 100%. He went on to comment:

“We have to strike a difficult balance between allowing sufficient scope for professional judgement and ensuring that the variation in cost estimates is not so great as to destroy confidence in our profession”.

Mr. Suttie said he would like to see the profession reach a “clearer consensus” on a form of generally accepted actuarial practices in pension valuation, which would provide guidelines, without placing rigid restraints on the judgment of the individual actuary. He suggested that such a consensus should provide guidelines for the calculation of individual valuations with disclosure as the key element in establishing and ensuring credibility:

“An actuary should provide an opinion based on more standard procedures, which would always be included in the actuarial report. Then, he could provide further projections, if there are other assumptions he thinks are appropriate.”

The actuary considers a multitude of variables to design benefit formulae and calculate a means to fund these projected outlays. The actuary must also respect his client’s needs and ability to fund a plan both in the short and long term. Therefore, because of differing employer desires, different funding patterns may be selected for otherwise similar companies. Both the actuarial cost method selected and the assumptions included in the given method are prime factors in the resulting funding differences.

Another concern that gives rise to considerable variability in pension costs is the difference in certain assumptions used to calculate pension benefits. Certain assumptions are more dependent upon the state of the economy than the actuary’s body of knowledge. Two very important factors in benefit calculations, the discount rate, and the wage escalation rate can have staggering effects on the pension liability calculation if modified by only one percentage point. The absolute percentages used may not be as important as the relevant spread between these two rates. It is important that the relevant relationship is realistic in the circumstances and reflects economic reality.

Certain key elements are presently not disclosed in determining pension liability and expense. The actuaries are instrumental in determining the pension cost. However, there is presently no disclosure required as to what cost method is used or what principal economic assumptions are.

### *The Committee's Observations and Conclusions*

The Committee believes that the subject of standardization of actuarial practices must be dealt with as two separate and distinct matters, one relating to the standardization of actuarial practices in the "corporate financial reporting" of life insurance companies, with attention directed to the appropriateness of actuarial assumptions in determining actuarial liabilities and reserves and, the second, concerning the standardization of actuarial practices as they pertain to individual pension plans and, in particular, employee pension plans.

Regarding the standardization of actuarial practices for the calculation of actuarial liabilities and reserves and for "corporate financial reporting" purposes, the Committee appreciates the efforts that have been made to standardize practices and, in particular, to develop one set of financial statements for regulatory authorities, policyholders and shareholders. On the other hand, the Committee is on record in previous Reports as being concerned that many regulations including solvency regulations may be anti-competitive. The Committee cannot avoid viewing in the same light any compulsory standardization of overall financial practices by insurers, including standardization of actuarial practices and evaluation of liabilities and reserves.

Thus,

- 13.9 While the Committee concurs with the general concept of the establishment of generally accepted actuarial standards for the valuation of actuarial liabilities and reserves of life insurance companies, the Committee believes that valuation actuaries should have a degree of flexibility in establishing assumptions based upon actual experience and professional judgment. The Committee therefore is not prepared to recommend that standards be made mandatory and indeed would view such standardization by regulation as having some adverse effect on competition and consumer choice.

Turning now to the standardization of actuarial practices as they pertain to individual pension plans, the Committee's main concern is from the point of view of the consumer, normally the employee, and his dependants. While the Committee anticipates that the Royal Commission on the State of Pensions in Ontario will have more to say on the subject of adequacy in the funding of pension plans, the Committee adds its own general comments on this topic in the following observations and recommendations.

As a basic premise, the Committee believes that the participants in pen-



sion plans are entitled to know the status of the portion of the pension plan in which they are involved. A number of insurers provide employees regularly with information concerning the employee funding and the employer funding of the plan and the expected future pension income of the participant. The Committee finds this practice very desirable.

- 13.10 The Committee encourages insurers to provide those covered by pension plans, normally employees, with data on a regular basis concerning the employee funding of the plan, the employer funding of the plan and the expected future pension income of the participant.

Concerning the standardization of actuarial practices in the valuation of liabilities and reserves of pension plans, the Committee has much less difficulty accepting the concept of standardization than in the “corporate financial reporting” case referred to above. Indeed the Committee is of the view that the standardization of procedures and practices regarding the preparation of reports on pension plans would aid participants in plans to understand and evaluate their plans better.

Therefore:

- 13.11 The Committee recommends that the Canadian Institute of Actuaries and life insurers make every effort to foster standardization of actuarial practices concerning pension plans at least as a “benchmark”, so that an actuary’s report on a pension plan will be based on and refer to standard assumptions and procedures and indicate the extent and significance of any deviations from these standards and the qualifications he may deem appropriate in the particular circumstances.

More standardization would likely require less disclosure of detailed assumptions and methods.

The direction of the Committee’s concern is towards the standardization of, at least, benchmark reporting and to provide additional credibility to actuarial conclusions concerning pension plans.

In general:

- 13.12 The Committee encourages insurers to improve the ongoing disclosure regarding employee and similar pension plans by providing participants on a regular basis with reminders concerning the nature of the plan as well as current data regarding the assets of the plan and other relevant data concerning the status of the plan.

### **3. Mutualization**

#### *History*

The concept of the mutual company is not new to Canada. The first mutual company in Canada, now called the Mutual Life Assurance Company of Canada, was incorporated in 1869. Other companies at the time



considered the concept but with a number of failures in the United States of mutual companies, mutuals fell from favour because of their lack of the cushion of equity capital.

As early as 1927 there was concern over the possibility of foreign take-overs of Canadian life companies. This did not occur to any extent but mutualization was seen as a means of thwarting such an eventuality.

In 1957, to reduce the possibility of more foreign ownership of life insurance companies, the Canadian and British Insurance Companies Act was amended to permit stock companies to mutualize by acquiring their own shares for cancellation. As a result five Canadian companies mutualized. Later, in 1965 changes were made to legislation to prevent non-residents from acquiring in the future more than 25% of the shares of a stock insurance company. This legislation ended the danger of more foreign control so there has been no further need to mutualize companies for this reason. While effectively the status quo has been maintained as a result of the 1965 legislation, a number of foreign owned life insurance companies were operating in Canada before that date and as a consequence there is still a significant foreign ownership of life insurers in the country.

At present, of the 154 federally registered life companies, with total insurance in force of \$278 billion, 43 are mutual life companies, underwriting approximately half of the life insurance in the country. These include Canada Life, Confederation Life, Mutual Life, Manufacturers Life, Sun Life and North American Life, who are among the 15 largest life insurance companies in Canada. In fact, mutuals accounted for 10 of the 15 largest insurance companies operating in Canada in 1978.

Stock companies can still mutualize under The Canadian and British Insurance Companies Act but the Minister of Finance must approve the change. Since the 1965 legislation as mentioned earlier, there has been no surge to mutualization.

### *Consequences of Mutualization*

The “owners” of a mutual company, the participating policyholders, have significantly different rights than stock shareholders in a stock insurance company. The major differences in ownership rights can be summarized as:

- Each policyholder is entitled to one vote, with no distinction for size of policy held. Stock owners vote in proportion to their investment.
- There are thousands of voting policyholders in each company, with no dominant “shareholder”. This is usually not the case in a stock company.
- The policyholders are not entitled to requisition a special meeting, which

can be done in stock companies by 25 shareholders holding 10% of the total value of the subscribed shares.

- Mutual companies generally refuse to supply lists of policyholders on the grounds of confidentiality, so a dissident policyholder finds it almost impossible to circularize other policyholders for support. This is not the case in stock companies as lists of stockholders are readily available.
- A frequent solicitation for proxies can be extremely expensive, so there has been a tendency for mutual life insurance companies to solicit proxies for up to five years. In the case of the stock companies proxies are solicited annually.

It has been noted by some that policyholders are almost powerless to affect company policy and participate in any decisions and that the management of mutuals is virtually self-perpetuating. Further, it has been suggested that since mutual companies have no stock and therefore do not have their "shares" listed on any stock exchange, they do not attract the interest of investment analysts who might raise questions regarding the operational efficiency of companies and compare the performance of individual companies. In this regard, the Superintendent of Insurance does not fill the void since he is more concerned with solvency and gives little, if any, attention to the operating performance of companies. Those with this view conclude that the performance of Boards of Directors is never challenged since no group is actively reviewing the efficiency of companies on a comparative basis.

The implication of those holding this view concerning mutual companies is that, if a life insurance company is a stock company, scrutiny of management's performance takes place and as a consequence the management of stock companies are more responsive to the concerns of both policyholders and shareholders.

Some years ago Professor E. P. Neufeld suggested as one possible solution that some independent, but public oriented organization could assume the role of appraising the performance of both mutual and other life insurance companies using efficiency criteria for the guidance of prospective policyholders.

The Committee does not share the view that there is any significant difference in the responsiveness of the management of mutual and stock insurers to their "investors" as the insurance industry is organized and operates in Canada today.

While there may be technical differences in the manner in which Boards of Directors of mutual and stock life insurance companies are elected, there is little difference in fact. The Committee notes also with particular interest that life insurers differ from all other financial institutions in Canada in that they alone are particularly immune from "equity" control and accountability. The shares of nearly all stock companies are closely held

by groups and therefore the problems of the ability of the minority shareholder to exercise their rights, the tendency of a self-perpetuating management and the improbability of dissident shareholders or policyholders making changes, are similar for both mutual and stock companies.

## E. GENERAL OBSERVATIONS AND CONCLUSIONS

As noted, the Committee has seen no evidence to indicate that there are any significant differences in the methods of operations of mutual and stock life insurers in Ontario. To repeat, aside from some legal distinctions, such as the mechanics of electing Boards of Directors, there is, in the Committee's view, little by way of underlying techniques and philosophies of management of mutuals and stock companies to differentiate their operating practices.

The Committee's concerns with the general operations of life insurance companies, however, go beyond the differences between stock and mutual companies and the manner in which the Boards of Directors of individual companies are elected. The Committee is much more concerned, for all companies, with the accountability of life insurance companies to their policyholders and to the community at large and the manner in which they discharge their responsibilities in this regard.

The precept expressed by the first federal Superintendent of Insurance that "directors are only trustees or agents for the disposition of the money entrusted to them by the insured" and his expression of the importance of *publicity* is as basic today as it was when stated by Mr. Cherriman more than 100 years ago.

The Committee does not wish to suggest that it is in any way casting any doubts on the integrity and ability of the management of any insurer past or present, or on the industry as a whole. However, since it is apparent that the degree of analyses, questions and probing that most corporations undergo is lacking in the case of most life insurers, it would seem to the Committee that a greater degree of self-imposed accountability to consumers by the industry as a whole and by individual companies should be encouraged by industry leaders.

The Committee was disturbed and frustrated in that it was unable to obtain a better understanding of a number of aspects of the operations of the life insurance industry, for example, matters relating to its investments, its operating expenses and efficiency and its sources of income other than premiums. The Committee believes that the Superintendent of the Province should have available to him a better perspective of the sources of income, the cost of operations and more specifically the investments of a segment of the financial community as important to the development of Ontario and Canada as the life insurance industry.



The Committee was particularly disturbed that there was no serious attempt on the part of insurers generally or individual companies to explain to policyholders the implications of the release of surplus as a result of the 1977 amendments to the Canadian and British Insurance Companies Act. While the Committee acknowledges that it may have been difficult for the CLIA to make an appropriate generalized comment that would be applicable to all life insurers, the Committee reviewed a number of annual reports of insurers that released significant amounts of surplus but noted that no significant comments were made in these annual reports concerning the implications of the release of these surpluses.

The Committee is strongly of the view that all participating policyholders are "entitled" to the surplus arising from transactions involving their policies and while it may not be appropriate in the judgment of management to distribute all of these surpluses, the policyholders are entitled to a good and complete accounting. Participating policyholders are promised that they will be participating in the better performance of the company and therefore should be kept fully informed regarding all aspects of its performance.

The Committee's expectation of full accountability by life insurers also includes more complete information concerning the investments of individual companies and the industry in total; a better perspective of all income and expenses; and, information to assist in assessing the efficiency of individual companies and the industry as a whole.

The life insurance industry has a monopoly among financial institutions in providing products where life expectancy is a consideration. In the case of life annuities, insurance companies compete amongst themselves as no other financial institutions are permitted to sell these products. As the only industry providing life annuities, it is axiomatic that life insurers assume responsibility for demonstrating efficiency. The importance of operating efficiency by insurers is amplified by the exclusive status held by life insurers in providing the life annuity option under RRSP legislation.

The Committee is reluctant to suggest any form of further government regulation or the establishment of an independent body to assist the industry to develop data that would be more useful to policyholders and consumers. Rather, the Committee believes that the industry itself should be more responsive and develop data and reports that will reflect the greater accountability of the industry as "trustees" of funds.

The Committee recognizes that the industry at present develops certain data on an industry-wide basis that is designed to inform policyholders and the community at large concerning the operations of the industry. While the Committee acknowledges these information services, it cannot help but view these efforts as historical summaries of the industry's accomplishments which do not address adequately the matters referred to as of concern to the Committee.



In sum:

- 13.13 The Committee is therefore disturbed by the apparent lack of individual company and collective industry emphasis on the importance of full and complete accounting and disclosure to policyholders.

The Committee agrees generally with the concept that the Directors of life insurance companies are trustees for the funds entrusted to them by policyholders and as such have a duty to keep policyholders informed regarding their stewardship.

Specifically, the Committee is concerned with the apparent lack of concern with the importance of meaningful accounting and disclosure of all relevant information regarding any surplus arising from participating policies.

- 13.14 The Committee is reluctant to recommend specific legislative measures that would improve the accountability of the industry in the future. Rather, the Committee urges individual life insurers, industry leaders and the industry as a whole to reassess its role as trustees for policyholders and to develop a perspective that recognizes the importance of a full and complete accountability to policyholders and to the community at large.

- 13.15 In particular, the Committee urges the industry to justify in much more informative ways than at present its use of surplus, the investments it holds, its sources of income, its expenses of operations and criteria for measuring the performance and efficiency of individual companies and the industry.

The life insurance industry has a monopoly among financial institutions in providing products where life expectancy is a consideration. As the only industry providing these products, it is axiomatic that life insurers assume responsibility for demonstrating efficient management. In the case of life annuities, insurance companies compete amongst themselves as no other financial institutions are permitted to sell these products. The importance of operating efficiency by insurers is amplified by the exclusive status held by life insurers in providing the life annuity option under RRSP rules.

## PART VII

### SUMMARY OF CONCLUSIONS AND RECOMMENDATIONS



## CHAPTER 14

### Summary of Conclusions and Recommendations

The following is a summary of the Committee's conclusions and recommendations with respect to the business of life insurance in this Province and with respect to the regulations which pertain to that business.

The Committee's observations, conclusions and recommendations are set out in full throughout the body of this Report, starting with Chapter 4 and continuing to Chapter 13. The Committee urges the reader to refer to the full text of the Committee's conclusions to understand the context of the recommendations listed below and to refer to the Committee's ancillary observations. Furthermore, the reader should note that the Committee has given consideration to issues not included within the following listing, but addressed in the individual chapters.

#### **CHAPTER 4: INDIVIDUAL LIFE INSURANCE PROVIDING DEATH BENEFITS**

##### **4.1 The Committee recommends that Part V of The Insurance Act:**

- (a) recognize the duty of life insurance companies to inform consumers about product characteristics salient to the choice of product alternatives; and
- (b) Recognize the duty of the Superintendent to supervise life insurance companies in that regard.

##### **4.2 The Committee has concluded that the nature and number of products developed by the life insurance industry has grown so complex that the Office of the Superintendent must direct a significantly increased effort toward consumer protection in more than just the area of insurer solvency. In this regard, the Committee expects the Superintendent to take an active role in requiring from life insurers an explanation of their products and information activities in order to satisfy himself that adequate and fair explanation of such products is being presented to the consumer. The Superintendent's authority to request full information is already provided for in Section 14 of The Insurance Act.**

##### **4.3 However, the Committee is satisfied that the life insurance industry in this Province is sufficiently mature and responsible so that the Superintendent can fulfil his supervisory duties in regard to consumer information requirements without the need for prior approval of policy forms, product literature and the like. Rather, the Committee expects that the Superintendent's initiative in calling from time to time for policy information will demonstrate the government's interest in the industry's product design and information practices and will be sufficient to ensure that a mature industry is fulfilling its information duties.**



The Committee suggests that the Superintendent consider periodic public hearings, requiring from life insurers a public explanation of new or existing products and information practices.

- 4.4 Should the Superintendent have reason in the future to be dissatisfied with the industry's response to its duty to inform, then the Committee recommends that the Superintendent undertake to implement more stringent reporting requirements such as prior policy approval.
- 4.5 The Committee recommends that the fundamentals of life insurance be defined in a standard form so they can be understood by the consumer. In continuing with the trend to better product information, the Committee believes that standard definitions of life insurance products should be adopted by those companies carrying on the business of life insurance and by the Office of the Superintendent of Insurance in supervising the activities of the industry.

These definitions would be intended to facilitate the consumer's understanding of what he is buying, by reducing the complexity of choice to basic categories of product. Where life insurance products differ from the standard definitions, these differences should be brought to the consumer's attention.

- 4.6 To enact standard definitions, the life insurance industry and the Office of the Superintendent should cooperate in defining, in simplified language and in terms somewhat like the following:

#### *Term Insurance*

- as basically a product providing a single benefit, that of financial protection for dependants upon the death of the insured
- as temporary, for a specified term and not for as long as the insured lives
- as providing continual coverage without fear of uninsurability only upon the policy being renewable and convertible
- as having a lower initial cost than a whole life policy for the same level of coverage but as subject to increasing cost at each renewal to maintain a fixed level of coverage, as one grows older.

#### *Whole Life Insurance*

- as a product providing a primary benefit, that of financial protection for dependants upon the death of the insured
- as permanent protection, providing continual coverage for as long as the insured lives, without any fear of uninsurability
- as sold on a level premium basis so that equal payments are made for as long as the insured lives—this means that, in the early years of the policy, the premiums are higher than needed for death protection

- as providing ancillary benefits, which if exercised reduce the value of the primary benefit.

Similar definitions should be developed for endowment insurance and basic combination policies. These definitions should describe each basic product in terms salient to the choice of alternative products.

- 4.7 The Committee recommends that all insurers make available to their policyholders, at appropriate cost, options to renew, convert and extend coverage to either term or permanent plans of insurance. The Committee believes these options, to be exercised without evidence of insurability, should include:

- The right to renew term coverage;
- The right to convert term coverage to permanent coverage;
- The right as a cash surrender option to convert permanent coverage to various choices of term coverage;
- The right to extend coverage to larger amounts of insurance, either on a term or permanent basis, regardless of whether the initial purchase was of term or permanent insurance.

The Committee concludes that it be mandatory that all insurers offer the options listed above at the appropriate cost with all policies sold.

- 4.8 In investigating the operations of life insurers in this Province, the Committee concludes that there is no need in Ontario at this time to set legislative standards for benefits payable under life insurance contracts or to specify what ancillary benefits or options for settlement at death or surrender should be made available as minimum requirements under contracts of life insurance. However, the Committee is of the opinion that the freedom provided to life insurers in designing policies and setting benefits requires that The Insurance Act impose a stronger obligation on life insurance companies to disclose benefit values and options pertinent to the contracts they sell.

- 4.9 Accordingly, the Committee recommends that The Insurance Act in Ontario be amended to provide under Section 149 and elsewhere if appropriate, that disclosure of all benefit values guaranteed under the contract be made mandatory and that insurers should be required to include in policies pertinent tables of benefit values for thirty years or until age 75 whichever is greater. Included should be disclosure of the amount of insurance money payable and all cash, paid-up or extended values related to contract surrender.

- 4.10 In regard to both guaranteed and non-guaranteed benefits, the Committee further recommends that the Act be amended to require mandatory disclosure in the policy of the conditions and options under which insurance money is payable, conditions under which other benefits can

be exercised including benefits to renew or convert coverage, and conditions under which benefit privileges expire.

- 4.11 The Committee recommends that the Superintendent assess the need for regulations pertaining to illustrations of non-guaranteed benefits, particularly in the area of adjustable benefit policies or variable premium policies.
- 4.12 The Committee recommends to the industry that industry-wide standardization with respect to conditions of eligibility for rider coverage and conditions under which rider benefits can be exercised would be of significant assistance to consumers. The Committee furthermore suggests that the Superintendent undertake to review periodically the conditions under which riders are sold and the adequacy of information provided to consumers.
- 4.13 The Committee recommends that the cost of principal riders should in all cases be disclosed separately from the cost of the basic policy. The Committee believes such disclosure is essential and should be part of the system of disclosure outlined in Chapter 9 of this Report.
- 4.14 As the Committee believes that few life insurance buyers will take the time and effort to shop around for policy riders, the Committee recommends that the cost of principal riders should be determined on a consistent basis among all companies in that the Superintendent should undertake to establish a loss-ratio rule for pricing as has been developed in the case of creditor's group insurance.
- 4.15 The Committee has reached the following further conclusions with respect to:

The waiver of premium rider:

- The limit of six months before benefits are collected may be too long for some policyholders. The Committee suggests that more options might be made available by life insurers.
- Some policies permit reinstatement of the policy within one year after policy lapse with proof of disability at the time the policy terminates. The Committee finds this provision to be a beneficial practice on the part of some insurance companies and urges other companies to adopt this provision.

The accidental death rider:

- The accidental death rider provides additional coverage only in the situation of death by accident. It has been argued before the Committee that, if the need exists for additional insurance, it exists regardless of the circumstances of death.

The Committee believes that the insured should be made aware ex-

PLICITLY of the alternative to buy full life insurance coverage, on a term basis if appropriate, rather than pay a premium for an accidental death rider. Such information should be provided to the prospective policyholder at the point of sale, as part of a system of disclosure to be detailed in Chapter 9 of this Report.

- The accidental death rider can be denied on the basis of certain underwriting criteria related to the perceived increased risk of accidental death. For example, it is not offered after a certain age as poorer health could precipitate an accident. The underwriting criteria for denial of the rider are not consistently determined nor are they necessarily determined objectively on actuarial evidence.

The Committee expects that the insurance industry, given its current technological capability to collect and analyze underwriting data, will begin to eliminate underwriting criteria used to rate the accidental death rider, where such criteria cannot be determined objectively based on actuarial evidence.

- The Committee shares the concern that the 90 day limit, within which the insured must die as a result of accident for his beneficiaries to collect on the accidental death rider, may be too restrictive for those kept alive by artificial means. The Committee urges the life insurance industry to develop a more flexible provision in its life insurance contracts that allows for claims to be accepted beyond the 90 day period if reasonable proof can be given that death occurred as a result of accident.

The guaranteed insurability option:

- It is the Committee's recommendation that the life insurance industry provide term insurance as an option under a guaranteed insurability rider, such that the policyholder, in exercising his right to buy additional amounts of insurance at standard rates, will have a choice of additional amounts of either term or whole life coverage. The Committee believes this choice should be made available under all guaranteed insurability riders sold.

#### 4.16 The Committee is concerned about the adverse effects on the consumer that occur in many situations when policies are lapsed. The Committee believes that current levels of lapsation can be reduced.

The Committee concludes that the best means of preventing poor product choice by consumers and thereby reducing the tendency to lapse is through providing the consumer with more meaningful cost and product information at the point-of-sale and policy delivery. The Committee outlines its recommendations for such a system of disclosure in Chapter 9 of this Report.

Should current rates of lapsation persist, the Committee recommends



that the Superintendent consider further means to correct this problem. The Committee directs the Superintendent to consider recommending that companies regularly monitor their own lapse rates based on a specified acceptable method and disclose their rates in their annual statements. Alternatively lapse rates could be reported to the Superintendent, with the Superintendent being required to identify in his annual report companies with unusual persistency patterns, and to develop an industry standard, such as a 15 percent first-year lapse rate, against which individual companies would be compared.

- 4.17 The Committee recommends that policy replacement should be treated in a manner identical to that of an original solicitation, with sufficient information being provided in both cases to provide the opportunity for a consumer to make an informed decision.

It is the Committee's general observation and conclusion with respect to the topic of life insurance replacement that replacement regulation should be addressed as part of a broader consideration of the disclosure needs of the life insurance buying public, rather than as a separate issue to be judged as "good" or "bad" for the policyholder. The Committee will address in detail the topic of a disclosure system for sale of life insurance in Chapter 9 of this Report.

- 4.18 To protect consumers in situations of policy replacement by permitting them time to consider the reasons for retaining their existing policies, the Committee recommends that the Superintendent give consideration to the need for requiring that insurers provide a 20-day period within which replacement policies can be terminated with full refund of premiums.

- 4.19 It is the Committee's further recommendation that the offence of "twisting" as a separate offence under Section 357 of Part XIV of The Insurance Act should be withdrawn from that Part of the Act.

In the absence of Section 357 of the Act, the Committee recommends that the Superintendent's authority to take action with respect to misleading representations, incomplete comparisons or coercion to purchase a policy of life insurance, be reinforced by amendments to Part XVIII of the Act to include in clear terms such acts or practices as "unfair or deceptive". In this same regard, the Committee points out that the Superintendent is already able to examine and investigate, under Section 388(b)(vi), situations involving "any incomplete comparison of any policy or contract of insurance with that of any other insurer for the purpose of inducing, or intending to induce, an insured to lapse, forfeit or surrender a policy or contract".

- 4.20 The Committee urges the life insurance industry to continue improving its practices with respect to reducing delay and paying interest on

claims when delay occurs, in *all* claims situations, including claims under policy riders and claims for the cash surrender value of the policy.

- 4.21 The Committee urges the life insurance industry and the Superintendent to cooperate in a review of the special problems that arise in respect to a claim under circumstances of disappearance or difficulty in establishing death. The Committee believes that standard practices should be developed in dealing with such claims situations, and that these practices should be enforced by the Office of the Superintendent, if necessary.

## **CHAPTER 5: ANNUITIES AND INDIVIDUAL RETIREMENT PLANS**

- 5.1 The Committee recommends that immediate attention be given to amending The Insurance Act in Ontario to include annuity contracts explicitly within the scope of the insurance business governed by the Act. Attention should be given in the Act to defining both a life annuity and an annuity certain in a practical and non-ambiguous manner. Amendments to the Act should further ensure that the provisions of The Insurance Act which apply to life insurance apply uniformly to annuities, except where specifically excluded for reasons of inappropriateness.
- 5.2 The Committee recommends that the duty of life insurance companies to inform consumers, recommended as a provision in law by the Committee in application to the business of life insurance which provides death benefits, apply equally to the business of annuity contracts.
- 5.3 The Committee recommends that the particulars of a mandatory system of disclosure for annuities be worked out by the Superintendent, corresponding to recommendations made by this Committee with respect to disclosure for individual insurance policies as detailed in Chapter 9 of this Report. The Committee emphasizes the particular importance of point-of-sale disclosure with respect to single-premium, immediate life annuities, as the 10-day rescission right provided for most life insurance products is generally not applied to single-premium or immediate annuities, whose payout values vary in accordance with changes in market rates of interest, which are subject to change at any time.
- 5.4 Whether or not a mandatory system of disclosure for annuity products is adopted by the government, the Committee recommends that Part V of the Act be reviewed and amended to take into account the business of annuities. The Committee recommends that specific attention be given, in amending Part V, to provisions governing the contents of an annuity policy.

- 5.5 Specific provisions should be made in Part V of The Insurance Act, with reference to deferred annuities, for disclosure as part of the policy contents of:
- the annuity options available upon maturity of a deferred annuity;
  - the amount, if any, guaranteed to be paid annually per \$1,000 of premium contributed under the life annuity option of a deferred annuity contract, if a life annuity is included as an option at maturity;
  - redemption privileges, if any, and the conditions or qualifications pertaining to redemption, including special conditions pertaining to policies registered as RRSPs;
  - the amounts, if any, payable upon redemption, that is, the guaranteed cash surrender value, set out in a table for the period to maturity of the annuity; or the methods of determining redemption values, if not guaranteed;
  - the amounts or methods of determining redemption or withdrawal penalties, if any.
- 5.6 Specific provisions should be made in Part V of The Insurance Act, with reference to the payout period on immediate annuities, for disclosure as part of the policy of:
- the periodic income guaranteed payable under the immediate annuity contract, stated on an annual or more frequent basis;
  - statement of differences in the amount of periodic income payable, if paid on a more frequent than annual basis;
  - methods of determining the periodic amounts payable under the annuity contract, if not guaranteed or if not level in amount.
- 5.7 The Committee recommends that the industry make universal the practice of stating in the policy and in sales proposals the rate of return applied to a deferred annuity contract. The Committee furthermore recommends that, where rates of return are stated in the policy or are advertised, the manner in which the rate is calculated and set out should be subject to consistent standards of disclosure that serve to protect the consumer against misunderstanding and confusion. The Committee recommends that the Superintendent include appropriate standards as regulations under The Insurance Act.
- 5.8 The Committee endorses the method of quoting rates of return on “a gross premiums paid” basis, with a clear statement that the rate of return is based on gross contributions, and with additional full disclosure of the total of all front-end load charges, which will include administration fees and commissions payable. Nevertheless, the method of quoting the rate of return could be left to individual company discretion so long as standards of disclosure are rigorously followed with respect to identifying the basis for the rate of return calculation. This

matter should be considered by the Superintendent in developing comparable standards of disclosure for annuity products.

- 5.9 In light of the many annuity products now available from life insurance companies for purposes of providing retirement income, particularly under registered plans, the Committee urges the life insurance industry to re-examine its marketing of permanent life insurance policies as RRSP vehicles, given that the primary purpose of a life insurance policy is to provide death benefits. Stricter guidelines than those currently adopted by the CLIA must be implemented to inform the consumer that loss of insurance coverage would result if RRSP annuity options were exercised and to make it possible for the policyholder to compare the results of registering a life policy with other methods of accumulating funds for RRSP purposes.
- 5.10 In regard to annuity products, the Committee strongly urges the life insurance industry to re-examine its product design and methods of product pricing so as to:
- design products that attempt to protect the real value of annuity benefits over time while maintaining products that guarantee benefits, to provide choice to consumers;
  - make participating annuities more attractive to consumers;
  - provide better opportunities for applicants to purchase substandard life annuities, when such applicants can provide evidence of shorter life expectancy.

These are all areas in which the Committee believes significant insurer efforts are urgently required to demonstrate the ability of a private system to meet retirement income needs now and in the future.

## **CHAPTER 6: GROUP INSURANCE**

- 6.1 The Committee recommends that the field of group life insurance should be addressed specifically and completely in The Insurance Act. The business of group life insurance is a mature business with clearly established standards of operation. These standards, where they are in the best interests of the public should be recognized in The Insurance Act as applicable to all companies licensed in this Province.
- 6.2 The Committee recommends further that the current rules of the Association of Provincial Superintendents of Insurance which govern group life insurance be formally adopted in life insurance regulation. The Committee recommends that the Superintendent undertake to amend or expand the group rules in accordance with the Committee's further recommendations in this Chapter before they are brought under a statutory framework.
- 6.3 The Committee emphasizes that the primary purpose of regulations



pertaining to group life insurance coverage should be to provide group insured lives with the assurance of continuity of coverage, particularly with respect to situations of termination of group coverage and with respect to persons who are disabled while covered by a contract of group insurance, even if that contract is terminated at some later date. In regard to the latter point, the Committee recommends that The Insurance Act be amended to make it mandatory that all group contracts provide waiver of premium coverage in the event of disability.

- 6.4 The Committee concludes in regard to the probationary work period provision in group contracts that if employers are to be compelled to provide insurance benefits to new employees from the moment they are hired, then such regulations should be considered as part of The Employment Standards Act. The Committee does not recommend such regulation in The Insurance Act.
- 6.5 The Committee finds that the actively-at-work condition of eligibility for group coverage is just as likely to deny coverage to employees who are insurable as good risks as to exclude bad risks from group coverage. The Committee concludes that the actively-at-work requirement should be eliminated as a general condition of eligibility for group coverage. The only condition of eligibility that an employee would then need to satisfy for group coverage would be to show that he or she is a bona fide employee within the group sponsored for coverage.
- 6.6 The Committee recommends unequivocally that the rights of employees or other group insureds to convert their group life insurance to an individual policy upon termination of employment or termination of the group insurance contract should be formally set out in The Insurance Act.
- 6.7 The Committee recommends that the conversion privileges extended to group members state clearly that the full range of plans sold by the group carrier should be made available to the group insured.
- 6.8 In the event of termination of a group insurance contract that is replaced by insurance of a lesser amount, the statutory conversion privileges should provide the employee or group member with the right to purchase an individual plan of coverage at standard rates for the full amount of face value difference between the old policy and the new policy.
- 6.9 In the event of termination of a group insurance master contract that is not replaced, the current provisions of the rules governing group life insurance should be made mandatory.
- 6.10 The Committee recommends that The Insurance Act reflect the requirement that notice be given by the insurer to employees and to other group insureds as well as to the group policyholder at least 30 days be-

fore contract termination, thereby allowing group members a total of some 60 days in which to consider and act upon the necessity of an individual plan of insurance. This recommendation intends that the insurer remain liable for coverage until 61 days after notification of the intent to terminate coverage is sent to group members.

- 6.11 The Committee recommends that the joint responsibility of the group sponsor and group insurer in matters of determining eligibility and notifying group members of termination of coverage or other change in eligibility status be set out in The Insurance Act.

This recommendation should in no way deny the insurer's overriding responsibility to notify group insureds of termination of the contract and their rights to convert to individual plans of insurance.

- 6.12 The Committee does not believe that the guidelines governing creditor's group insurance should, for the present time, be incorporated into regulation, although close monitoring of the efficacy of these guidelines should continue through the Office of the Superintendent. The Committee emphasizes that the ongoing responsibility of the Superintendent should be to ensure that charges for creditor's group life insurance, whether of a specific or non-specific nature, are at the lowest possible rates.

- 6.13 The Committee recommends that life insurance companies licensed in this Province be prohibited from selling life insurance related to the outstanding debt on a residential mortgage loan if the borrower is restricted by the lending institution in his choice of insurer, to the insurer with which the mortgage lender customarily does its business. Financial institutions failing to advise borrowers that mortgage life insurance can be obtained from the borrower's choice of insurer and to identify its cost separately to the mortgage borrower should be placed in the position of contravening the provisions of The Business Practices Act or appropriate legislation. The Committee recommends appropriate amendments to both The Insurance Act and The Business Practices Act.

- 6.14 In the light of a number of recent studies concerning the adequacy of the pension system in Canada and in this Province and the special statutes covering pension matters, the Committee's intent in this Report is to ensure that life insurance companies are recognizing their responsibility to improve the products and services available in a *private* system of benefit protection, rather than to address the full spectrum of issues in the pension field.

- 6.15 It is particularly important, in the Committee's view, that life insurers pursue improvements in pension plans *on behalf of* the smaller group plans which tend to use insurance companies as their primary funding agency and rely on the insurers as the experts in pension advice.

- 6.16 The Committee recommends that insurers should undertake to treat all pension groups alike in computing investment yields and for purposes of dividend distribution, unless specific segregated funds are set up for individual pension groups.
- 6.17 Particular areas in the pension field, where the Committee sees an urgency for industry initiatives, especially on behalf of the smaller group plans, include:
- portability of pensions;
  - pension indexing and flexibility to cope with the effects of inflation;
  - understandable information about the terms of group coverage provided to each individual group member; and
  - adequacy in funding of pension plans and initial and ongoing disclosure to group members concerning fund adequacy.

## **CHAPTER 7: THE UNDERWRITING PROCESS IN INDIVIDUAL LIFE INSURANCE**

- 7.1 The Committee recommends that the life insurance industry in its underwriting practices must start with the premise that everyone is a standard risk and must only rate a person as substandard or deny coverage on the basis of personal risk characteristics if those characteristics can be proven systematically to require that an extra premium be assessed. The Committee contends that the life insurance industry must reduce its reliance on medical judgment and on the judgment of the underwriter. These conclusions of the Committee are not intended to eliminate entirely the role of judgment in underwriting but they are intended to reduce that role as much as possible.
- 7.2 The Committee recommends that all life insurance companies licensed in this Province and preferably across Canada should participate in an industry-wide program to collect and analyze mortality statistics on risk factors used in the underwriting process.
- 7.3 The Committee recommends that the Superintendent of Insurance require all life insurance companies licensed in this Province to report to him summary statistics on the numbers of policies rated and the numbers of applications denied.
- 7.4 The Committee further recommends that the Superintendent from time to time conduct enquiries into the underwriting practices of life insurance companies and require that evidence be presented to support the use of various risk factors as underwriting criteria.
- 7.5 After reviewing the matter of risk classification on the basis of sex, the Committee concludes that, to the extent such risk classification is actuarially sound and makes insurance a more equitable and affordable



means of income protection, it cannot be described as inherently unfair. The Committee believes generally that risk classification is a beneficial practice in that it reduces the chances of an inequitable premium burden over the whole population of insureds, that is, it reduces cross-subsidization of risks. Specifically with regard to the matter of risk classification on the basis of sex, the Committee finds that such classification is actuarially sound in basis. Accordingly the Committee recommends no change in The Insurance Act with respect to the freedom of life insurers to practise risk classification by sex.

7.6 On the other hand, the Committee recognizes that risk classification by sex can be questioned on social grounds as a discriminatory practice. The Committee has given extensive consideration to this perspective on the issue of risk classification by sex. The Committee has concluded that because of changing social perspectives on sex discrimination, no change should be made to The Insurance Act at this time to “protect” in the Act the present system of risk classification by sex. Accordingly, any future initiatives by insurers to remove sex as a rating criterion or any future broadening of the provisions of The Ontario Human Rights Code to include discrimination with respect to insurance matters would not require a corresponding amendment to The Insurance Act. The Committee does not however advocate any such broadening of The Ontario Human Rights Code at the present time.

7.7 One further matter has come to the Committee’s attention in studying the matter of risk classification. The Committee notes that Section 114 of The Insurance Act reads as follows:

“Any licensed insurer that discriminates unfairly between risks in Ontario because of the race or religion of the insured is guilty of an offence.”

The Committee recommends that this section be amended to eliminate the word “unfairly” in order to remove any doubt that discrimination can be practised if based on actuarial proof of life expectancy differences for classes of risk defined by race or religion.

7.8 The Committee further draws the attention of the Superintendent to the provision of The Ontario Human Rights Code which names, among other factors, race, creed, colour, nationality, ancestry or place of origin as characteristics with respect to which discrimination is prohibited. The Committee recommends that these characteristics be considered by the Superintendent for inclusion in Section 114 of The Insurance Act.

7.9 The Committee recommends that standards with respect to the confidentiality and use of personal information collected for underwriting purposes should be set out in regulations to The Insurance Act, with



appropriate amendment to the Act to require compliance by the industry and supervision by the Superintendent.

- 7.10 In general terms the Committee recommends that regulations with respect to confidentiality and use of personal information provide that:
- individuals are told what kind of information is being collected about them, how it will be used and to whom it will be disclosed;
  - individuals should be able to see and obtain a copy of their records and correct any errors;
  - individuals should be assured that there will be no improper disclosure of their records;
  - individuals should be told the basis for any adverse underwriting decision that may be based on personal data.
- 7.11 As a specific matter related to use of personal information, the Committee recommends that every denial or adverse rating of an application for life insurance should be accompanied by a formal written notice delivered to the applicant stating the reason or reasons for the adverse underwriting decision. The Committee recommends that this requirement be incorporated into The Insurance Act as a separate duty of life insurers under Part V of the Act or as part of the regulations previously recommended in regard to standards of confidentiality and use of personal information.
- 7.12 The Committee expects that the life insurance industry in this Province will prove that regulations prohibiting informal applications are not required. That is the Committee expects that all life insurance companies will treat each enquiry about a life insurance plan as an application to the extent of notifying the prospective purchaser in writing of the reasons for policy denial or adverse rating.

Should the Superintendent obtain evidence of any increase in the use of informal applications by insurers to escape the obligation to notify prospective policyholders in regard to the insurer's decision to deny an applicant coverage or rate the applicant as a substandard risk, then the Committee recommends that the Superintendent consider the statutory requirement that no insurer can refuse to state the reason for denial or substandard rating of coverage to a person who believes he has applied for coverage, even if such application is treated informally. Appropriate protection might be afforded to the insurer in certain circumstances when denial or rating of coverage may be based on reasons such as suspicion of criminal activities by the "applicant".

- 7.13 The Committee is generally satisfied that the standards of the M.I.B. with respect to confidentiality of the information which it collects and files are quite strict and a reasonable protection to life insurance applicants and policyholders. Of concern to a number of members on the Committee is the reliance of life insurance companies in Canada on an

industry-support organization located in the United States. While the Committee would prefer to see personal information on Canadians remain with an organization indigenous to Canada, the Committee is for the present time satisfied that the interests of Canadian and Ontario policyholders can be protected by mandatory standards of personal information use and disclosure applied to life insurance companies licensed in this Province.

- 7.14 The Committee therefore recommends that mandatory standards of personal information use and disclosure applicable to insurance companies should be formulated so as to control the privacy of information held by industry-support organizations such as M.I.B. who derive their information from the life insurance industry. The Committee recommends that an appropriate requirement in this regard could provide that each insurance company should exercise reasonable care in the selection and use of insurance support organizations, so as to assure that the practices of such organizations comply with the privacy standards set out in regulations to The Insurance Act.

## **CHAPTER 8: THE PRICE OF LIFE INSURANCE**

- 8.1 The Committee believes that it is in the general self-interest of insurers who wish to conserve their older, existing permanent policies to offer their long-term non-participating policyholders the option of converting their policies to participating policies, if they should wish to do so. Some companies have already provided this option.

The Committee urges all companies to follow this lead and to look at ways of permitting conversion of non-participating policies to participating policies.

Likewise the Committee urges life insurers to permit conversion of participating policies to non-participating policies for those consumers wishing to make such a change during the lifetime of their policies.

- 8.2 The Committee is concerned however that the ability to convert policies to either non-participating or participating policies may, in some cases, be offered only upon the request of the policyholder. As a result, many policyholders may not be aware of their company's practice to allow conversion.

The Committee therefore recommends that life insurers notify each policyholder at the next policy anniversary and at appropriate intervals thereafter about the extension of these privileges to convert to participating or non-participating policies, whichever be the appropriate case. Such notices should however point out that the dividends paid on participating insurance are not guaranteed as they are dependent on future levels of interest rates, mortality experience and expenses.

- 8.3 The difference in the relative premium costs of participating and non-participating insurance is a matter which the Committee believes is most important to a person who has limited resources for purchase of insurance. The difference should be expressly pointed out to prospective purchasers of life insurance, preferably in mandatory disclosure material provided to the consumer at the time of sale. The prospective purchaser should be alerted to ask his agent how much insurance can be bought for a given premium if the policy is participating and alternatively if it is non-participating.
- 8.4 The Committee recommends, as essential, a number of practices which should be strictly adhered to by life insurance companies in regard to the illustration and payout of dividends:
- The hypothetical nature of dividend illustrations should be clearly and effectively identified to life insurance purchasers to guard against misunderstandings by consumers.
  - Policyholders should be given maximum flexibility in the use of their dividend funds, particularly with respect to the opportunity to fund additional insurance to prevent the eroding value of insurance coverage. This flexibility should not only be in the form of a range of dividend options but should also permit policyholders to switch their choice of dividend options over the lifetime of their policy.
  - Insurers should undertake to inform consumers on a periodic and ongoing basis of available dividend options to assist consumers in correct selection and revision of options to meet their changing needs.
  - Insurers should undertake to adhere to a “portfolio method” of dividend distribution, wherein all policyholders, other than those buying variable contracts with segregated investment funds, are treated alike in computing dividends. Because insurers act as trustees for the funds of their policyholders and not as intermediaries for investment of policyholder funds, the responsibility of insurers should be to treat all policyholders equally and equitably in the distribution of dividends. That is, dividends for all policyholders should be calculated using the overall rate of investment yield on the company’s total assets.
- 8.5 In studying the life insurance industry, the Committee has come to the general conclusion that price comparison must play an important role in the marketing of life insurance. Not only is price comparison essential to price competition but the importance of price information is magnified by the current inflationary environment and its effect on the value of life insurance benefits. Without meaningful price information, the consumer is unable to maximize his purchase of insurance coverage and hence minimize the effects of inflation on the death protection he buys.
- 8.6 Based on review of the elements of price and the various methods of



cost comparison of life insurance products, the Committee concludes further, as a general statement, that an effective system of price comparison should include:

1. Mandatory disclosure of basic cost data, including:

- the yearly premium by age
- the amount payable on death
- the amount payable on surrender
- the illustrated dividend
- any other significant cash benefit,

to be provided for the basic policy and all supplementary benefits and riders.

2. Widespread use and availability of cost indicators that will permit life insurance buyers to compare the cost of similar life insurance policies. This suggests as well the need for a Shoppers' Guide type of publication as a "yardstick" for cost comparisons on the basis of currently recognized cost indices.
3. A measure of cost that will permit comparison of dissimilar policies.

However price information should not, in the Committee's opinion, be considered in isolation but rather in the context of comprehensive system of disclosure, a topic which the Committee intends to address in some detail in the recommendations which follow under Chapter 9.

## **CHAPTER 9: DISCLOSURE**

- 9.1 The Committee recommends, based on its study of the life insurance industry, that The Insurance Act be amended to provide for a system of mandatory disclosure, with a precise format for disclosure set out in regulations to The Insurance Act.

The Committee's study into life insurance has led it to conclude that the elements of information required by the consumer in a comprehensive mandatory disclosure system can be categorized under the following headings:

- information about life insurance as a means of financial protection and about the different types of life insurance; that is, **PRODUCT INFORMATION**.
- yearly information on premiums, dividends, amounts payable at death and amounts payable upon policy surrender; that is, **YEARLY DETAILED POLICY INFORMATION**.
- summary information applicable to comparison of the cost of similar policies among companies, for example, the company retention index; that is, **SUMMARY COST INDEX INFORMATION**.



- summary and yearly information on the cost of protection in each policy; that is, COST OF PROTECTION INFORMATION.
- summary and yearly information applicable to comparison of the cost of different cash value policies, that is, RATE OF RETURN INFORMATION.

In the Committee's opinion, the effective presentation of this information requires that certain of the elements of information outlined above be provided:

- at the point of sale;
- at policy issue and delivery; and
- on a periodic, ongoing basis.

## **At The Point of Sale**

### *“The Guide to Buying Life Insurance”*

9.2 The Committee recommends that each consumer receive at the point of sale, either from the agent or directly from the insurer, a “guide to buying life insurance”.

This guide should be a short booklet in standardized form and should:

1. Be in simplified language and in easily readable format.
2. On the first page, list a series of important questions which the applicant should pose to his agent in order to make a life insurance purchase best suited to his needs.
3. Indicate that life insurance should not be bought without carefully assessing one's personal situation in regard to how much insurance should be bought and for what purposes.
4. Indicate that the consumer think carefully before replacing a policy.
5. Explain the basic types of life insurance coverages and explain the level premium method of paying for life insurance.
6. Explain that premiums alone do not always reveal the true cost of life insurance coverage.
7. Explain generally the concept of using Cost Indicators to shop for the best price, with more detailed explanation of each Cost Indicator to be explained a outlined in the points below. As there is no one comprehensive measure of the cost of a life insurance policy, which permits comparison of similar policies and also dissimilar policies, the Cost Indicators to be explained in the guide should include:

- a Summary Cost Index, preferably the Company Retention Index

- a Cost of Protection index
  - an Average Rate of Return on cash value policies
8. Explain the concept of a Summary Cost Index in shopping for the best price. Two possibilities include the Company Retention Index and the Interest-Adjusted Net Cost Index.
  9. Explain the concept of using a Cost of Protection index to shop for the best policy.
  10. Explain how the Average Rate of Return can be used to compare the cash value benefits of policies with this feature.
  11. Explain other features of life insurance that should be brought to the consumer's attention.
  12. Include a final alert to consumers buying non-guaranteed policies, including

*The "Point of Sale Policy Summary"*

9.3 The Committee also recommends that, at the point of sale, each consumer receive a "point of sale policy summary".

This policy summary should:

1. Identify the policy by indicating the name of the company, the type of policy by its generic name, the name of the policy as used by the company in advertising, the amount payable at death, the policyholder's sex and age at issue, and whether the policy is participating or non-participating.
2. State, for whole life or endowment insurance:
  - the annual premium for a standard-rated risk
  - the annual premium for supplementary benefits, these being identified separately as:
    - waiver of premium rider
    - accidental death rider
    - guaranteed insurability option.
3. State, for term insurance or for term riders:
  - the initial amount payable on death and the initial annual premium
  - the amount payable on death for representative future policy years and the annual premium then payable
  - the cash surrender value for representative future policy years, if available under a level premium policy
  - whether the term insurance is renewable and, if so, through what age
  - whether the term insurance is convertible and, if so, through what age.

4. State for whole life, endowment and term insurance, summary Cost Indicators for the policy being offered.

The Committee believes that the following three Cost Indicators for life insurance provide the consumer with the comprehensive information needed to evaluate policy choices both among similar policies and among dissimilar policies. These measures are:

- a Summary Cost Index, preferably the Company Retention Index,
- the Cost of Protection, that is, the cost of the policy per \$1,000 of protection,
- the Rate of Return on cash value policies.

Each of these measures of cost should be summarized over stated periods of time as an average Cost Indicator. To give consumers a better idea of how good a buy a policy would prove to be if held for various periods of time, the Committee believes that a display of average or index numbers should be provided for a 5 year, 10 year, 20 year and 30 year period.

The Committee further believes that these Cost Indicators would be most useful if provided first at the point of sale as well as at the time of policy issue when yearly financial information should be provided.

Further comments on each Cost Indicator follow.

### ***The Summary Cost Index***

As stated, the Summary Cost Index should be provided at specified periods of time, such as 5, 10, 20 and 30 years. Two possibilities for use as the Summary Cost Index include the Company Retention Index and the Interest-Adjusted Net Cost Index.

The Committee is of the view that the Company Retention Index is a meaningful method of comparing similar policies at the point of sale. It measures how much, in present value terms, policyholders on the average can expect the company to retain out of their premium payments for expenses and profits. The amount not retained is used for provision of protection and cash value benefits.

The Committee recommends the choice of the Company Retention Index as the Summary Cost Index for point of sale disclosure.

### ***Cost of Protection***

The resolution of an appropriate measure of the Cost of Protection should be undertaken by the industry and the Superintendent. The Committee points out however that it finds the methodology of the Company Retention Index a useful precedent towards Cost of Protection calculation.

### ***Rate of Return***

The resolution of an appropriate measure of an Average Rate of Return should be undertaken by the industry and the Superintendent.

5. In the case of an adjustable benefit or new money policy, point out that the amounts payable upon death are not guaranteed. As these policies are often funded by a single premium, substantial disclosure must be provided at the point of sale.

Illustrate the amount of extra insurance payable if market rates of interest rise in the future; illustrate the amount of extra premium which would be required to maintain a constant amount payable upon death if market rates of interest fall in the future.

State the guaranteed minimum amount payable at death.

### *Summary of Point of Sale Disclosure*

- 9.4 The Committee recommends that the distribution of a standardized “guide to buying life insurance” and a “point of sale policy summary” be made mandatory by amendments to The Insurance Act. Both documents should be provided at the time of:

- application when dealing personally with an agent or life insurance sales representative or when selling single premium life insurance;
- within 10 days after application when buying life insurance through the mail or by telephone.

The agent should be required to complete the “point of sale policy summary” form when he takes an application.

- 9.5 The Committee recommends that the life insurance industry together with the Superintendent should cooperate in drafting an appropriate guide and policy summary in a form that is meaningful to the consumer. The Committee is confident that the industry is fully capable of carrying out this important task. The Superintendent should approve the efforts of the industry before implementation. If the industry fails to reach consensus on a guide and point of sale policy summary, the Committee recommends that this task be undertaken by the Superintendent.
- 9.6 The Committee recommends that the cost of printing and distribution of point of sale disclosure documents should be borne by life insurance companies. In the event the Superintendent is required to produce the disclosure documents, the costs of such production should be allocated among life insurance companies in proportion to the amount of business they write in this Province.
- 9.7 The Committee has recommended that the following three Cost Indicators be provided to the consumer at the point of sale of a life insurance policy:
  - the Company Retention Index
  - The Cost of Protection
  - the Average Rate of Return on cash value policies.



However, as an interim measure before implementation of the disclosure system outlined in this Chapter, the Committee recommends that the life insurance industry undertake without further delay to state to each prospective policyholder at the point of sale the Interest-Adjusted Net Cost Index for the policy being proposed for his needs. An explanation of the use of this index should also be provided and reference should be made to the industry-sponsored survey of life insurance prices which the Committee expects the industry to publish before the end of this year.

### **Time of Policy Issue**

- 9.8 As a further mandatory disclosure requirement, the Committee recommends that detailed yearly financial information be provided to the purchaser of life insurance at the time of policy issue in the form of a detailed policy information document.

The Committee recommends that this mandatory detailed policy information document contain yearly information on:

- the premium by age;
- separately, the additional amount of premium payable for a risk rated as substandard, by age;
- the amount payable on death;
- the amount payable on surrender, if any;
- the illustrated dividend, if any;
- any other significant cash value benefits, such as paid up insurance;
- any significant use of dividends, for life insurance benefits, such as additions to the amount payable on death and the amount payable on surrender.

This yearly display of information should be provided for 30 years or to age 75 whichever is the longer period.

- 9.9 The Committee also recommends that the detailed display of financial information include, on a year to year basis, a measure of the amount of protection bought by the premium, the yearly price per \$1,000 of protection and, for cash value policies, the yearly rate of return.
- 9.10 The Committee further recommends that a summary of the detailed financial information should be provided at the time of policy issue, including as applicable the Company Retention Index, at specified periods of time, such as 5, 10, 20 and 30 years; the Cost of Protection, that is, the average cost of the policy for \$1,000 of protection if the policy is held for 5, 10, 20 and 30 years; the Average Annual Rate of Return on cash value policies, if surrendered at 5, 10, 20 and 30 years.

- 9.11 The Committee further recommends that a right of rescission during the 10 day period after policy issue and delivery be guaranteed to life insurance policyholders in The Insurance Act.

### **Ongoing Disclosure**

- 9.12 The Committee recommends that at policy renewal or every 5 years, whichever is less, policyholders receive an updated, detailed policy information document and summary identical to that delivered to the policyholder at policy issue.

Outlined in the ongoing disclosure documents should be:

- yearly data on premiums, dividends, amount payable on death, amount payable on surrender, and amounts of paid up insurance as outlined earlier;
- yearly amounts of protection and the yearly price of protection;
- a yearly rate of return on cash value insurance;
- any decrease in benefits as a result of policy loans;
- any increase in benefits as a result of dividends left with the insurance company to purchase additional coverage.

These data should extend ahead in time from the policy's nearest anniversary date to the policyholder's 75th birthday or for 30 years whichever is the longer. A summary of the above, as provided at the time of policy issue, should be attached.

- 9.13 The Committee also recommends that a further disclosure document be provided at policy renewal, or every 5 years, whichever is less, indicating:
- the beneficiary named;
  - settlement options taken or available;
  - dividend options taken or available;
  - the current rate of interest on policy loans and on dividends left on deposit;
  - any conditions which could materially change the individual's status as a policyholder, for example, expiry of accidental death or waiver of premium coverages.

### **Enforcement**

- 9.14 The Committee recommends that the purchaser be given the right under insurance law to return his policy and obtain a full refund within fourteen months after the policy is delivered if the purchaser can show that mandatory disclosure requirements were not fully complied with.

### **Annual Survey of Cost Index Ratings**

- 9.15 The Committee recommends that the Superintendent ensure that a

comprehensive annual survey of life insurance prices is made available to the public in Ontario. The Committee recommends, however, that the onus to publish this annual survey be placed on the life insurance industry.

If the life insurance industry fails within a reasonable amount of time to demonstrate that it will take on the publication of this survey on an ongoing basis, the Committee recommends that the Superintendent should consider such a production, with cost to be borne by the industry.

## **CHAPTER 10: MARKETING LIFE INSURANCE AND THE AGENCY SYSTEM**

- 10.1 The Committee recommends that Section 342(13) referring to single company representation be removed entirely as a compulsory requirement in The Insurance Act, under the conditions that follow.
- 10.2 The Committee recommends that the agent sponsorship provision should be retained, requiring an insurer to sponsor an applicant to act as an agent in selling and servicing his products.

In regard to the requirement that agents continue to be sponsored by insurers, the Committee emphasizes that the sponsoring requirement should not be held as a mere formality. The sponsoring insurer should be held responsible under law for the actions of the agent sponsored.

- 10.3 The Committee recommends that the sponsoring insurer should be permitted to continue using the single company representation system or a modified system by means of its contractual relationships with its own agents.
- 10.4 The Committee recommends that the agent should be authorized both to act as an agent on behalf of the sponsoring insurer and to negotiate insurance with any other life insurer licensed to carry on business in Ontario subject to the terms of the agent's contract with his sponsoring insurer.
- 10.5 The Committee recommends that the same degree of responsibility for the acts of its agent inherent in a life insurer's sponsorship of the agent should apply also to a life insurer who accepts an application from a life agent who was not sponsored by such insurer.
- 10.6 The Committee concludes that at the present time it is not prepared to recommend that a change be made in The Insurance Act to provide for licensed brokers. The Committee believes that removal of the single company provision in the Act may facilitate already apparent trends towards development of agents who negotiate insurance with a number of insurers.

- 10.7 Nevertheless the Committee believes that close attention should be given by the Superintendent to developments in the marketing of life insurance which may at some time lead to the formal recognition in the Act of a new category of sales intermediary, that of the life insurance broker. At that time, attention may be required in regard to licensing and supervision requirements or in regard to some form of self-regulation for the life insurance broker.

## **CHAPTER 11: LICENSING, QUALIFICATIONS, TRAINING AND CONDUCT OF LIFE INSURANCE AGENTS**

- 11.1 The Committee recommends that the sponsoring life insurer should be delegated responsibility in The Insurance Act for ensuring that its agent receives supervision, education and training appropriate to the agent's knowledge, experience and progress in the business.
- 11.2 The Committee recommends that the sponsoring life insurer should also be required to accept responsibility for the acts of the agent and for any financial responsibility normally inherent in the principal-agent relationship, subject to any form of indemnity agreements between the insurer and the agent.
- 11.3 The same degree of responsibility for the suitability and acts of its agent inherent in a life insurer's sponsorship of the life agent should apply to a life insurer who accepts an application from a life agent not sponsored by such insurer.
- 11.4 The Committee recommends that the requirement for the Superintendent of Insurance in this Province to licence life insurance agents should be removed from The Insurance Act.
- 11.5 In place of licensing, the Superintendent should undertake, as a public service, the registration or recording of names of life insurance agents sponsored by life insurance companies.

The duty of life insurance companies to keep the Agent Register records up-to-date should be made a statutory duty.

Persons selling life insurance and not on the Agent Register should be held as guilty of committing an offence under The Insurance Act, unless such persons are of a class of sales intermediary specifically exempted from registration.

These requirements should replace the current provisions in Part XIV of The Insurance Act.

- 11.6 The Committee recommends that non-resident agents be subject to separate regulation under the Act and/or to a form of licensing if such is found to be necessary by the Superintendent.
- 11.7 The Committee recommends that salaried employees of a licensed in-



surer who act for such an insurer in the negotiation of any contracts of life insurance or annuities or their renewal need not be required to be registered with the Superintendent as life insurance agents. These persons would not, however, be given the authority to negotiate insurance with other insurers.

On the other hand, the Committee recommends that commissioned exclusive life insurance agents, bound to a single insurer by contract, should be registered as agents with the Superintendent.

- 11.8 Should a public complaint arise in regard to an agent, the Superintendent should identify the sponsoring company of the named agent from the Agent Register and should direct all complaints to the sponsoring insurer for resolution or correction.

If the complaint involves insurance negotiated with other than the sponsoring insurer, then the life insurer accepting the application from the agent should be required to resolve or correct the complaint.

If complaints arising in regard to unfair or deceptive acts as practised by agents are not satisfactorily resolved by the insurer involved, the Superintendent should be authorized under the Act to take action against the insurer under authority of Part XVIII of The Insurance Act.

- 11.9 The Superintendent should maintain a record of complaints by agent, by company and by reason for the complaint. The Superintendent should publish annually in his Annual Report a summary review of the complaints registered with him, by name of the company for which the agent acted.

- 11.10 Where persistent or serious complaints arise with respect to the acts of any one named agent, the Superintendent should be authorized to strike the name of that agent off the Agent Register, subject to an appeal process.

The Superintendent's authority to determine what constitutes persistent or serious complaints needs to be defined only broadly in the Act. Reference should be made to provisions in Part XVIII of the Act and to provisions in The Business Practices Act as indicative of the unfair practices which might warrant the striking of the name of an agent off the Agent Register.

- 11.11 The Committee recommends that the Minister of Consumer and Commercial Relations introduce an amendment to The Business Practices Act so as to make it applicable to life insurance and to insurance in general.

In particular, the Committee recommends that the provisions of The Business Practices Act which pertain to:

- (a) a false, misleading or deceptive consumer presentation
- (b) an unconscionable consumer representation
- (c) and any other unfair practices that fall under that Act,

should apply to the life insurance industry and to all persons involved in the marketing and counselling of consumers in regard to a program of life insurance.

- 11.12 The Committee further recommends review of the parts of The Insurance Act that pertain to agent conduct, in particular Part XVIII of the Act which deals with the “unfair and deceptive acts or practices in the business of insurance”, in regard to any modifications that may be needed to include the thrust of the provisions of The Business Practices Act in that Act’s elaboration of false, misleading, deceptive or unconscionable consumer representations.
- 11.13 In general, the Committee recommends that the authority given to the Superintendent under Part XVIII of the Act to investigate agent and insurer conduct should remain broad in scope and should be supplemented by intermediate penalties, as well as the penalty of prohibiting the agent or the insurer from engaging in the business of life insurance. In the event that complaints warrant that action be taken against an agent under Section 388 of Part XVIII of the Act, the Committee recommends that action should also be allowed against the sponsoring insurer or the insurer of account on the basis of the same complaint.
- 11.14 The Committee recommends that life insurance companies take into account the following matters in sponsoring a person to act as a life insurance agent:
- That the applicant is a suitable person, in terms of character, reputation, educational background and previous record in business to hold himself or herself out publicly and carry on business in good faith as an insurance agent.
  - That neither the applicant nor his spouse, nor *any* officer, director, shareholder or employee of a corporation, nor any partner or employee in a partnership, where sponsorship is extended to a partnership or a corporation, should be in a position of undue influence or self-interest to secure insurance business.
  - When sponsorship is extended to a partnership or corporation, that sponsorship should be extended to each representative of the partnership or corporation in the business of life insurance.
- 11.15 The Committee recognizes the continuing need for part-time agents and encourages life insurers in setting their own requirements of suitability for agents to allow, at the least, part-time agents in those

circumstances presently specified in Regulation 539 or, preferably, to permit agents to be part-time agents in other circumstances where their further activity, occupation or business does not result in a position of undue influence on prospective policyholders.

- 11.16 As a related matter to that of the further occupation or activities of life insurance agents, the Committee recommends that the sponsoring insurer undertake to ensure that the true status of its life insurance agents is not obscured in representations to the public.  
Insurers should ensure that all their agents:

- state that they are a life insurance agent in regard to any business which may and does result in negotiation of an insurance program;
- name the sponsoring insurer;
- advise the prospective policyholder whether or not he is bound by contract to a single insurer;
- state the situations in which he is free to place insurance with other insurers, if bound by contract to a single insurer.

- 11.17 In the matter of life insurance agents who hold themselves out as “consultants”, the Committee recommends that such holding out need not be prohibited, but that life insurers should ensure that their agents disclose in a non-ambiguous fashion, in any situation where they call themselves “consultants” in life insurance or in financial or estate planning matters, that they are also sponsored and commissioned agents, who obtain remuneration from the life insurance companies with which they place insurance business.

- 11.18 In regard to persons who call themselves “life insurance consultants” but are not agents or employees of life insurance companies, that is are not permitted to take applications for or negotiate contracts of life insurance, the Committee concludes that such persons should not be prohibited by The Insurance Act from using the term “life insurance consultant”.

- 11.19 The Committee recommends that satisfactory completion of a basic course should be required of every applicant wishing to become an agent before sponsorship is granted to him or her to act as an agent. The basic course should be made a common course for all applicants.

The Committee recommends that responsibility for development of and continuing public access to a basic course qualifying a person to be sponsored as an agent should be delegated to the life insurance companies in this Province.

- 11.20 The Committee further recommends that this basic course be held in a “public forum”, so that it does not become dependent on the facili-



ties or training staff of any one insurer. Preferably the course should be held in a public educational facility.

The Committee recommends that the industry discuss the matter of basic agent training with public education officials as a form of vocational training, with the intention that the network of community colleges in this Province might accommodate this vocational training program.

The Committee recommends that insurers should be prepared to pledge to public education officials that they will assume some part of the cost of the basic training program and that they will contribute to the staff and curriculum development of these courses.

- 11.21 The Committee recommends that the development of the basic course and its completion standards be carried out by the industry, with the full cooperation of industry associations including the CLIA and LUAC and with the participation of public education representatives and the Office of Superintendent.

The completion standards for this course should be significantly improved over the standards of the present qualifying examination for a life agent's licence.

- 11.22 If life insurance companies fail to respond to this recommendation within five years, the Committee recommends that the Superintendent of Insurance move to set up a basic training course and introduce amendments to The Insurance Act requiring all agents to participate and pass the examination in such a course.

- 11.23 In the event that the Committee's recommendations with respect to suspension of the licensing requirement for life insurance agents are not followed by the government, the Committee recommends:

- That agents be permitted under The Insurance Act to negotiate insurance with other than their sponsoring insurer, if allowed by contract, as recommended by the Committee in its recommendation 10.1 in Chapter 10.
- That sponsorship of life insurance agents by a life insurance company continue to be required under the Insurance Act, as recommended by the Committee in its recommendation 10.2 in Chapter 10.
- That The Business Practices Act be amended to make it applicable to life insurance and to insurance in general, as recommended by the Committee in this Chapter in its recommendation 11.11.
- That the parts of The Insurance Act that pertain to agent conduct



be reviewed and revised to include the thrust of the provisions of The Business Practices Act in that Act's elaboration of false, misleading, deceptive or unconscionable consumer representations, as recommended by the Committee in this Chapter in recommendations 11.12 and 11.13.

- That responsibility for determining suitability of an applicant for licensing, in accordance with the current or revised regulations under the Act, that pertain to suitability, be delegated formally in The Insurance Act to the sponsoring insurer.
- That agents be permitted, under The Insurance Act and its regulations, to act as part-time agents, in specified circumstances, as referred to by the Committee in this Chapter in its recommendation 11.15.
- That the situation of corporations and partnerships sponsored as life insurance "agencies" be fully considered in The Insurance Act and regulations, to ensure that proper representation is made to the public, as determined to be appropriate by the Superintendent.
- That improved specification of holding out requirements and including reference to disclosure of the status of exclusive agents bound by contract to a single insurer be incorporated in The Insurance Act and regulations, specifically as recommended by the Committee in this Chapter in its recommendation 11.16.
- That The Insurance Act require disclosure of the status of a person as a commissioned life insurance agent for those agents holding themselves out as "consultants", as recommended by the Committee in this Chapter in its recommendation 11.17.
- That The Insurance Act and regulations recognize reciprocal licensing of non-residents as life insurance agents.

11.24 In regard to the matter of agent conduct, the Committee recommends that, with the retention of licensing, requirements pertaining to the conduct of licensed agents should be referred to in The Insurance Act and prescribed in regulation and that these require the agent:

- To ensure that in any contact with the public in matters of life insurance or annuities, it is made absolutely clear:
  - that he or she is a life insurance agent;
  - whether or not he or she is bound by contract to a single insurer; and
  - the situation(s) in which he or she is free to place insurance with other insurers.
- To enter all information required to be completed by the agent on

mandatory disclosure documents provided to the prospective insurance purchaser at the point of sale.

- To safeguard any information which is given to him in confidence by policyowners or prospective purchasers.
- To attempt to have a medical, occupational or other rating removed from an existing policy in those instances where it becomes known that such a reduction may be possible.

The Committee recommends that the Superintendent give consideration to any other standards of conduct which should be imposed in regulation on licensed agents to ensure that agents act in the best interests of the policyowners.

- 11.25 In regard to the matter of training, the Committee recommends that even with retention of licensing, the Superintendent should delegate the responsibility for establishing the training and examination requirements for qualification for a new agent's licence to the life insurance companies, in accordance with the Committee's recommendations in this Chapter, that is recommendations 11.19 to 11.22. Under these recommendations, the Committee expects the industry to develop a common, basic course for all new agents, with this course to be held in public educational facilities. Completion of such a course, or some designated part of this course, should be required before application for the licence of an agent.

## **CHAPTER 12: REMUNERATION METHODS FOR LIFE INSURANCE AGENTS**

- 12.1 The Committee concludes that commission consistency is a matter requiring significant attention by the life insurance industry in order for the industry to meet its public interest responsibilities. The Committee encourages the life insurance industry to strive for actuarial consistency in the payment of commissions.

To demonstrate that each insurance company is striving for this objective, the Committee recommends that the actuary's annual certificate be amended to include reference to the extent to which the company has applied actuarial consistency in commissions in the premiums for its products.

- 12.2 The Committee reaffirms its previous recommendations with respect to a comprehensive, mandatory system of cost disclosure for life insurance policies, as an approach to informing consumers about the cost of their policies that is preferable to disclosure of the commissions paid to the agent.
- 12.3 The Committee concludes that life insurance agents should be permit-

ted to charge a reasonable fee for services which go beyond the normal negotiation of insurance and where there is agreement with the recipient of such services. The Committee concludes that such fees or an appropriate part of such fees should ordinarily be offset against commissions payable to the agent when such services result in negotiation of a contract of life insurance and payment of commission to the agent.

The Committee recommends that Section 388(b)(viii) of The Insurance Act should be amended to clarify that a life insurance agent is not precluded from charging a fee for services under the preceding conditions specified by the Committee.

- 12.4 The Committee recommends that the practice of issuing of a life insurance policy for a reduced rate or reduced policy values by virtue of a reduction or elimination of the loading for commissions be examined carefully by the Superintendent as a possible form of unfair discrimination. Such examination should be conducted in the context of industry efforts to achieve actuarial consistency in commissions payable on life insurance policies. The Committee recommends that if the rebating of commissions is found to be unfairly discriminatory, then Section 356(2) of The Insurance Act should be amended to prevent avoidance of the section by the simple expedient of adjusting the premium or policy values before the policy is issued.
- 12.5 The Committee encourages the industry to pay commission or preferably fees for ongoing service or persistency, if appropriate to the policy sold, and to separate such commissions or fees from the payment of the original sales commission.
- 12.6 The Committee recommends that insurers be encouraged to charge only a portion of the commission in the first year against the cash value of the policy. Under the recently revised methods of calculating actuarial reserves, insurers have already developed formulae for deferring acquisition costs for financial reporting purposes. This same practice should be applied to the calculation of cash values, in a consistent manner for all policyholders. Where early lapse or termination of policies results, adjustment rules could be applied which would charge back against the amount of cash value payable, the unrecovered portions of the first-year premiums. No adjustments should be required for long-term policyholders.
- 12.7 The Committee recognizes that the decision by insurers about whether or not to vest commissions is of major concern to life insurance agents, but believes that this is a matter to be resolved by the participants in the life insurance industry rather than a matter for government intervention.
- 12.8 The Committee recommends that life insurance companies undertake



to employ a similarity of treatment of life insurance agents with respect to both in-house and out-of-house replacements of life insurance policies beyond an early lapse period, that period to be specified uniformly in application to all companies.

- 12.9 The Committee recommends that life insurance companies undertake to eliminate commission chargebacks in the circumstances where a waiver of premium rider is exercised because of disability of the policyholder and in situations related to the exercise of non-forfeiture options under the policy, except in circumstances of defined early lapse of the policy.

### **CHAPTER 13: PROFIT EMERGENCE, PROFIT DISTRIBUTION, AND OTHER MATTERS**

- 13.1 The Committee recommends that amendments be made to Section 15(1) of The Insurance Act to formalize the procedures to be followed when the Superintendent of Insurance adopts the inspection of another jurisdiction to review and examine the affairs of a life insurance company licensed to carry on business in Ontario. These procedures should include completion of a certificate to be received by the Superintendent in a form suitable to him that would outline the extent of the review and examination, whether the results of the review and examination were satisfactory and, if not, the specific deficiencies identified.
- 13.2 The Committee urges the Superintendent of Insurance of the Province to encourage the closer cooperation of his fellow provincial Superintendents and the federal Superintendent when matters relating to the solvency of insurers, in which all jurisdictions are jointly concerned, are under consideration for possible revision by any jurisdiction.
- 13.3 The Committee congratulates the life insurance industry on its excellent safety record as demonstrated by its ability to satisfy all policyholders' claims when due and acknowledges that this record is at least in part a reflection of the success of the management of its investments.
- 13.4 The Committee questions, however, the continuing appropriateness of the insurance industry's investment philosophy as being ultraconservative and suggests that the industry be encouraged to take advantage of a broader spectrum of investment opportunities available to it in Canada and of the greater margins available with these investments. The Committee encourages the industry in particular to participate more actively in real estate development and new energy programs.
- 13.5 The Committee believes that there is a continuing need for approved investments for insurance companies to be set out in statute. The Com-



mittee notes as well that life insurers have rarely, if ever, challenged as being too restrictive any of the limitations contained in statute. Nevertheless, the Committee proposes that the requirements as set out in the Act should be reviewed on a regular basis to ensure that they provide the flexibility necessary for insurers to take advantage of changing investment opportunities and participate fully in Canada's growth opportunities.

- 13.6 The Committee recommends that appropriate changes be made to the taxation legislation of the Province to exempt fraternal and mutual benefit societies from the payment of premium taxes on the life insurance premiums received from their members.
- 13.7 The Committee recommends the use of the Contribution Principle in determining dividends to be distributed by life insurance companies as being the most equitable method of dividing surplus among the policies in the same proportion as the policies contributed to the surplus to be distributed.
- 13.8 The Committee further recommends appropriate amendments be made in The Insurance Act to require that the valuation actuary for each insurer be required to include in his annual report that the Contribution Principle has been followed or, if the Contribution Principle has not been followed, a full statement concerning the deviations and their rationale.
- 13.9 While the Committee concurs with the general concept of the establishment of generally accepted actuarial standards for the valuation of actuarial liabilities and reserves of life insurance companies, the Committee believes that valuation actuaries should have a degree of flexibility in establishing assumptions based upon actual experience and professional judgment. The Committee therefore is not prepared to recommend that standards be made mandatory and indeed would view such standardization by regulation as having some adverse effect on competition and consumer choice.
- 13.10 The Committee encourages insurers to provide those covered by pension plans, normally employees, with data on a regular basis concerning the employee funding of the plan, the employer funding of the plan and the expected future pension income of the participant.
- 13.11 The Committee recommends that the Canadian Institute of Actuaries and life insurers make every effort to foster standardization of actuarial practices concerning pension plans at least as a "benchmark", so that an actuary's report on a pension plan will be based on and refer to standard assumptions and procedures and indicate the extent and significance of any deviations from these standards and the qualifications he may deem appropriate in the particular circumstances.

13.12 The Committee encourages insurers to improve the ongoing disclosure regarding employee and similar pension plans by providing participants on a regular basis with reminders concerning the nature of the plan as well as current data regarding the assets of the plan and other relevant data concerning the status of the plan.

13.13 The Committee is therefore disturbed by the apparent lack of individual company and collective industry emphasis on the importance of full and complete accounting and disclosure to policyholders.

The Committee agrees generally with the concept that the Directors of life insurance companies are trustees for the funds entrusted to them by policyholders and as such have a duty to keep policyholders informed regarding their stewardship.

Specifically, the Committee is concerned with the apparent lack of concern with the importance of meaningful accounting and disclosure of all relevant information regarding any surplus arising from participating policies.

13.14 The Committee is reluctant to recommend specific legislative measures that would improve the accountability of the industry in the future. Rather, the Committee urges individual life insurers, industry leaders and the industry as a whole to reassess its role as trustees for policyholders and to develop a perspective that recognizes the importance of a full and complete accountability to policyholders and to the community at large.

13.15 In particular, the Committee urges the industry to justify in much more informative ways than at present its use of surplus, the investments it holds, its sources of income, its expenses of operations and criteria for measuring the performance and efficiency of individual companies and the industry.

The life insurance industry has a monopoly among financial institutions in providing products where life expectancy is a consideration. As the only industry providing these products, it is axiomatic that life insurers assume responsibility for demonstrating efficient management. In the case of life annuities, insurance companies compete amongst themselves as no other financial institutions are permitted to sell these products. The importance of operating efficiency by insurers is amplified by the exclusive status held by life insurers in providing the life annuity option under RRSP rules.



## APPENDICES





## APPENDIX A

(referred to in the Preface)

### LIST OF WITNESSES

#### A. MINISTRY OF CONSUMER AND COMMERCIAL RELATIONS, ONTARIO

*Honourable Frank Drea, M.P.P., Minister*

Mr. R. A. Simpson, Executive Director, Business Practices Division

Mr. M. A. Thompson, Q.C., Executive Director, Financial Institutions Division

*Office of the Superintendent of Insurance in Ontario*

Mr. M. A. Thompson, Q.C., Superintendent of Insurance

Mr. L. P. Wood, (Former) Director of Insurance Services

Mr. M. L. Doherty, (Former) Registrar of Agents and Brokers

Mr. B. D. Newton, Senior Actuary

Mr. D. G. Triantis, Corporate Licensing Research Officer

Mr. F. Rahman, Actuary

#### B. INDUSTRY ORGANIZATIONS IN ONTARIO

*The Canadian Life Insurance Association*

Mr. D. W. Pretty, Chairman of C.L.I.A. and President of the North American Life Assurance Company

Mr. E. H. Crawford, President of C.L.I.A. and President of the Canada Life Assurance Company

Mr. G. M. Devlin, Executive Vice President of C.L.I.A.

Mr. F. C. Dimock, Senior Vice President and Secretary of C.L.I.A.

Mr. W. T. Morgan, Senior Vice President and General Counsel of C.L.I.A.

Mr. F. Kimantas, Vice President, Taxation, C.L.I.A.

Mr. F. W. Speed, Vice President and Actuary of C.L.I.A.

Mr. G. S. Thompson, General Administration Vice President of C.L.I.A.

Mr. C. C. Black, Vice President and Comptroller of the Prudential Insurance Company of America, Canadian Operations

Miss G. Boes, Director, Underwriting Services, North American Life Assurance Company

Mr. K. L. Kirk, Vice President, The North American Life Assurance Company

Mr. D. T. Loucks, President and Chief Executive Officer, Heritage Life Assurance Company  
 Mr. J. V. Masterman, Executive Vice President, The Mutual Life Assurance Company of Canada  
 Miss J. G. McKibbin, Manager, Actuarial Department, The London Life Insurance Company  
 Mr. J. B. Purdy, Financial Vice President, The Imperial Life Assurance Company of Canada  
 Mr. L. G. Rollerson, Senior Group Vice President, Crown Life Insurance Company  
 Mr. P. Safran, Statement and Tax Executive, The Canada Life Assurance Company  
 Mr. C. J. Stubbs, Legal Officer, The Excelsior Life Insurance Company  
 Mr. B. Tufford, Director, Underwriting Services, The Excelsior Life Insurance Company

#### *Life Underwriters Association of Canada*

Mr. R. G. Simmons, Chairman and Chief Executive Officer of L.U.A.C. and Branch Manager, The London Life Insurance Company  
 Mr. J. A. Bowden, President of L.U.A.C. and Partner in Tomlinson, Bowden, Brooks, Drinkwater, Polci & Crofts  
 Mr. R. L. Kayler, Executive Vice President and General Counsel of L.U.A.C.  
 Mr. A. W. Lingard, Executive Director and General Manager of L.U.A.C.  
 Mr. R. K. Giuliani, Member of the Executive Committee of L.U.A.C., and Branch Manager, The Great-West Life Assurance Company

#### *The Canadian Institute of Actuaries*

Mr. J. T. Birkenshaw, President of C.I.A. and President of Mony Life Insurance Company of Canada  
 Mr. Charles T. P. Galloway, President-Elect of C.I.A. and President of National Life Assurance Company of Canada  
 Mr. Samuel Eckler, Chairman, Committee on Qualifications and Conduct of C.I.A. and Chairman of Eckler, Brown, Segal & Company Limited  
 Mr. W. J. Saunders, Member of C.I.A., and Vice President, Individual Operations, Dominion Life Assurance Company  
 Mr. J. C. Maynard, Chairman, Committee for Strengthening Disciplinary Procedures of C.I.A., and Senior Vice President and Chief Actuary, Canada Life Assurance Company

*Canadian Life Insurance Medical Officers Association*

Dr. M. H. Henderson, President of C.L.I.M.O.A. and Medical Director  
of the Equitable Life Insurance Company

*The Canadian Fraternal Association*

Mr. David A. Griffin, President  
Mr. W. Kasprow, Counsel

**C. INDIVIDUAL LIFE INSURANCE COMPANIES IN ONTARIO**

*Canadian Reassurance Company*

Mr. M. Sales, President

*Dominion Life Assurance Company*

Mr. J. S. Acheson, President  
Mr. G. A. Coyne, Vice President, Individual Marketing  
Mr. D. Eckersley, Vice President and Actuary  
Mr. W. J. Saunders, Vice President, Individual Operations  
Mr. G. D. Baker, Corporate Services Executive and Secretary  
Mr. D. O. Janke, Superintendent, Policy Benefits  
Mr. L. E. Peppler, Superintendent, Equity Investment

*Eaton/Bay Financial Services*

Mr. W. R. Livingston, President  
Mr. J. D. Switzer, Senior Vice President  
Mr. B. E. Steinberg, General Manager, Mass Marketing

*Equitable Life Insurance Company of Canada*

Mr. T. R. Suttie, President  
Mr. D. L. MacLeod, Executive Vice President  
Mr. W. H. Wahl, Vice President, Corporate Services and Treasurer  
Mr. D. G. Seebach, Marketing Services Director  
Mr. G. E. Hartman, Regional Sales Division

*London Life Insurance Company*

Mr. E. H. Orser, Executive Vice President and Chief Operating Officer  
Mr. D. S. Rudd, Senior Vice President  
Mr. D. E. Creighton, Vice President, Marketing  
Mr. R. G. Mephram, Vice President, Group



Mr. J. Atkinson, Manager, Group Insurance  
Mr. R. A. Bennett, Conservation and Policyowner Relationships  
Mr. W. D. Jackson, Director of Marketing, Group Benefits Division  
Mr. J. C. A. MacDonald, Comptroller  
Miss J. C. McKibbin, Actuary  
Mr. J. A. Mereu, Group Actuary  
Mr. T. Moore, Director of Consumer Affairs and Marketing  
Administration  
Mr. A. Prentice, Group Health Claims, Manager  
Mr. W. Robinson, Assistant Actuary  
Mr. D. A. Smith, Director of Sales Compensation and Planning  
Mr. A. Telford, Superintendent, Group Benefits Division

*Lutheran Life Insurance Society of Canada*

Mr. H. A. Dietrich, President and Chief Executive Officer  
Mr. L. S. Klarke, Vice President, Agency  
Mr. D. J. Michael, Vice President and Treasurer  
Mr. S. A. Taylor, Vice President and Actuary  
Mr. J. Widdecombe, Vice President, Fraternal and Secretary

*The Maritime Life Assurance Company*

Mr. R. McEneaney, President  
Mr. N. Foran, Vice President Marketing

*Metropolitan Life Insurance Company*

Mr. J-P. Maurer, Executive Vice President, New York  
Mr. C. N. Armstrong, President, Canadian Operations  
Mr. William McKinnon, Counsel, Canadian Operations

*Mutual Life Assurance Company of Canada*

Mr. J. H. Panabaker, President and Chief Executive Officer  
Mr. J. V. Masterman, Executive Vice President  
Mr. D. R. Winhold, Senior Vice President and Treasurer  
Mr. A. Anderson, Agency Vice-President  
Mr. R. M. Astley, Executive Officer, Individual Insurance Services  
Dr. R. D. Atkinson, Medical Director  
Mr. D. E. Lahn, Marketing Administration Executive  
Mr. M. R. Reynolds, Investment Executive  
Mr. R. G. Setchell, Director of Manpower Development  
Mr. R. N. Thorlacius, Associate Treasurer

*Northern Life Assurance Company of Canada*

Mr. G. L. Bowie, President

Mr. I. D. McFarlane, Vice President, Insurance Operations and Actuary

Mr. C. D. Holland, Vice President, Group Operations

Mr. B. D. Hunter, Manager, Advanced Sales Training

Mr. J. W. Hutton, Director, Financial Analysis

*Occidental Life Insurance Company of California*

Mr. D. M. Onstad, President, Canadian Division

Mr. J. P. Connor, Vice President, Canadian Division

**D. INDIVIDUALS AND ORGANIZATIONS IN ONTARIO OTHER  
LIFE INSURANCE INDUSTRY PARTICIPANTS**

*Annuity Quotations and Insurance Agencies Ltd. of Toronto*

Mr. J. W. Brown

*Equifax Services, Limited*

Mr. Douglass R. Stewart, Vice President—General Manager

*Medical Impairment Study Committee, Society of Actuaries*

Mr. Donald L. Gauer, Vice-President and Actuary, Sun Life Assurance  
Company

*Mr. James Lackner*, Lackner, McPhail, St. Hill Insurance Agencies Ltd.  
of Kitchener, Ontario

*Mr. Kenneth MacGregor*, Chairman, Mutual Life Insurance Company and  
Former Superintendent of Insurance, Federal Department of Insurance

*William M. Mercer Limited*

Mr. Keith Mark, Director

Mr. R. Reid, Vice President, Toronto Office

*Mr. Chris Snyder*, Executive Compensation Consultants Ltd. and S.S.M.  
Insurance Agency Limited, of Toronto

**OTHERS**

*Canadian Association of University Teachers*

Dr. Donald Savage, Executive Secretary

Dr. R. Leger, Professional Officer

Dr. Patricia Speight, Professional Officer

*Clarkson Gordon*

Mr. R. C. Knechtel, C.A.

Mr. B. J. Olivella, C.A.

*Consumers' Association of Canada*

Mrs. Marian Kramer, President, Ontario Chapter

Mrs. Helen Anderson, Economics Committee

*Ms. Marie Corbett, LL.B.*

*Mr. C. H. Foster*, Ministry of Labour, Employment Standards Branch  
Equal Benefits Section

*Reuben A. Hasson*, Professor of Law, Osgoode Hall Law School, York  
University

*Mr. Albert Lam, P. Eng.*

*Mr. Elie W. Martel, M.P.P.*

*Mr. William E. McLeod*, Professor, Cambrian College

*Ontario Confederation of University Faculty Associations*

Dr. P. Wesley, Executive Secretary

**E. COMPANIES, INDIVIDUALS, ORGANIZATIONS AND  
GOVERNMENT REPRESENTATIVES IN THE UNITED  
STATES**

*Aetna Life and Casualty*

Mr. John Alden, M.D., Medical Director

Mr. James R. Bailey, National Sales Director

Ms. Frances R. Callanan, Manager, Public Policies Issues Analysis

Mr. Malcolm O. Campbell Jr., Counsel, Government Affairs

Mr. Robert L. Hill, Counsel

Mr. C. John Stubbs, General Counsel and Secretary, Excelsior Life  
Insurance Company

Mr. T. M. Sullivan, Counsel, Government Affairs

*American Council of Life Insurance*

Mr. Jack H. Blaine, Chief Counsel, State

*Dr. Joseph Belth*, Professor of Insurance, Indiana University

*State of Connecticut, Department of Insurance*

Honourable Joseph C. Mike, Insurance Commissioner

Mr. Robert E. Dineen, Consultant to the National Association of Insurance Commissioners

*The Federal Trade Commission*

Mr. David C. Fix, Attorney, Bureau of Consumer Protection

Mr. Michael P. Lynch, Economist, Bureau of Economics

*Hartford Chapter, Chartered Life Underwriters*

Mr. Jon W. Webber, President

*Insurance Association of Connecticut*

Mr. John G. Day, President

Dr. Spencer Kimball, Professor of Law, University of Chicago and  
Counsel to the American Bar Association

*Life Insurance Marketing and Research Association (LIMRA)*

Mr. Robert Carlson, Vice President

Miss Helen T. Noniewicz, Assistant Vice-President, Manpower and  
Market Research

*Medical Information Bureau, Inc. (MIB)*

Mr. Neil M. Day, President and General Counsel

Mr. James Corbett, Associate General Counsel

*Travelers Insurance Company, Hartford, Connecticut*

Mr. John H. Glover, Second Vice President





## APPENDIX B

(referred to in the Preface)

### LIST OF EXHIBITS AND SELECTED REFERENCE MATERIAL

#### LIST OF EXHIBITS

Copies of the Exhibits are available in the Legislative Library, Main Parliament Building, Queen's Park, Toronto, Ontario.

1. Submission to the Ontario Select Committee on Company Law from the Canadian Life Insurance Association, July 1979.
2. Presentation to the Select Committee on Company Law by Mutual Life of Canada, Waterloo, Ontario, July 19, 1979.
3. Submission to the Ontario Select Committee on Company Law from the Equitable Life Insurance Company of Canada, July 1979.
4. Submission to the Ontario Select Committee on Company Law from Lutheran Life Insurance Society of Canada, July 18, 1979.
5. The Dominion Life Assurance Company, Submission to the Ontario Select Committee on Company Law, July 1979.
6. Submission to the Ontario Select Committee on Company Law by London Life Insurance Company, July 1979.
7. Presentation to the Ontario Select Committee on Company Law by the Northern Life Assurance Company of Canada.
8. Presentation to the Select Committee on Company Law by the Superintendent of Insurance for the Province of Ontario, July 30, 1979.
9. A Compendium of the Dialogues and Views of the Life Insurance Agent in Ontario, submitted by the Superintendent of Insurance to the Select Committee on Company Law, on July 1979.
10. A Consumerist's View of Life Insurance, a Presentation to the Select Committee on Company Law, by William E. McLeod, August 2, 1979.
11. Consumers' Association of Canada, *Shoppers' Guide to Canadian Life Insurance Prices*, 1979 Edition, William E. McLeod, Editor and Publisher.
12. Presentation to the Select Committee on Company Law of the Ontario Legislature, by the Life Underwriters Association of Canada, July 1979, two volumes.
13. Submission to the Select Committee on Company Law by the Consumers' Association of Canada, September 4, 1979.

14. Submission to the Ontario Select Committee on Company Law from the Canadian Life Insurance Medical Officers Association, September 4, 1979.
15. Presentation to the Ontario Select Committee on Company Law by the Canadian Institute of Actuaries, September 5, 1979.
16. Submission of Douglass R. Stewart, Vice President—General Manager, Equifax Services, Ltd., before the Select Committee on Company Law, September 6, 1979.
17. Submission to the Royal Commission on Banking and Finance, by the Superintendent of Insurance, Ottawa, October 1962.
18. American Council of Life Insurance, "The Nature of the Whole Life Contract".
19. American Council of Life Insurance, "Company Life Insurance Costs".
20. National Association of Insurance Commissioners, "Model Life Insurance Replacement Regulation".
21. Summary of Presentation on Replacements Made to Ontario Select Committee on Company Law by John H. Glover, Second Vice President, Travelers Insurance Company, September 12, 1979.
22. "The Standard Valuation and Nonforfeiture Laws in the United States, 1858-1979", Statement before the Select Committee of the Ontario Legislature, by Robert L. Hill, Counsel, Aetna Life and Casualty, September 12, 1979.
23. Society of Actuaries, "Report to the Actuarial Committee of the Subcommittee on Actuarial Aspects of Valuation Problems", June 21, 1979.
24. Presentation of the Medical Information Bureau, Inc. to Ontario Select Committee on Company Law, by Neil M. Day, President, September 13, 1979.
25. The Medical Information Bureau, Inc. Handbook and Directory, 1979.
26. Reuben A. Hasson, "The Reform of Group Life Insurance Law", *Manitoba Law Journal*, Volume 9, No. 2, 1979, pp. 119-139.
27. Presentation to the Ontario Select Committee on Company Law, September 20, 1979, by Metropolitan Life Insurance Company.
28. Schedule of Investments, December 31, 1978, Metropolitan Life Insurance Company.
29. Submission to the Ontario Select Committee on Company Law from

Occidental Life Insurance Company of California, September 20, 1979.

30. Brief to Royal Commission on the State of Pensions, from Ontario Status of Women Council, December 31, 1977.
31. Appendix to Brief to Royal Commission on the State of Pensions, Prepared by Ontario Status of Women Council, March 1, 1978.
32. Submission to the Select Committee on Company Law of the Ontario Legislature by Lackner, McPhail, St. Hill Insurance Agencies Ltd., Kitchener, Ontario, September 25, 1979.
33. Notes and Exhibits of Mr. Albert Lam, P.Eng., in his submission to the Select Committee on Company Law, September 25, 1979.
34. Text of Letter Dated August 7, 1979, from Thomas Delaney, Economic Policy Committee, Consumers' Association of Canada to The Honourable John Crosbie, Department of Finance, Ottawa.
35. Exhibits submitted to the Select Committee on Company Law by Mr. J. W. Brown, Annuity Quotations and Insurance Agencies Ltd. on September 26, 1979.
36. Submission to the Ontario Select Committee on Company Law by the Canadian Fraternal Association, September 26, 1979.
37. Submission to the Select Committee on Company Law, Province of Ontario, September 1979, the Maritime Life Assurance Company.
38. Brief on Life Reinsurance, by Michel Sales, President, Canadian Reinsurance Company, September 26, 1979.
39. Presentation by Mr. R. C. Knechtel and Mr. B. J. Olivella of Clarkson Gordon, September 27, 1979 on Corporate Tax-Life Insurers and Taxation of Life Insurance Products (copies of overhead exhibits).
40. Exhibits submitted to the Select Committee on Company Law by Mr. Elie W. Martel, M.P.P. on October 2, 1979.
41. "The Single Company System of Agent Representation", A Presentation to the Ontario Select Committee on Company Law by the Mutual Life Assurance Company of Canada, October 2, 1979.
42. A Presentation to the Ontario Select Committee on Company Law, October 2, 1979, London Life Insurance Company.
43. Letter to James Breithaupt, M.P.P. Chairman and All Members of the Select Committee on Company Law from Mrs. Rebecca Liff, Ottawa, Ontario, dated September 6, 1979 and attached exhibits.
44. Notes and exhibits related to the Appearance before the Select Committee on Company Law of Eaton/Bay Financial Services, October 4, 1979.



45. Submission to the Ontario Select Committee on Company Law, by the Ontario Confederation of University Faculty Associations and the Canadian Association of University Teachers, October 4, 1979.
46. Letter from M. A. Thompson, Superintendent of Insurance, to the Chairman of the Select Committee on Company Law, October 4, 1979 re: Life Insurance—Prior Approval of Policy Forms.
47. Letter to Mr. J. Breithaupt, Chairman of the Select Committee on Company Law, from Ms. Doris Anderson, President, Advisory Council on the Status of Women, November 15, 1979.
48. Supplementary Submission to the Ontario Select Committee on Company Law from the Canadian Life Insurance Association, December 1979.
49. Presentation to the Ontario Select Committee on Company Law Regarding the Medical Impairment Study Committee of the Society of Actuaries and the Association of Life Insurance Medical Directors of America and related material, by Mr. D. C. Gauer, January 22, 1980.
50. Letter, and attached exhibits, to Mr. James R. Breithaupt, Chairman, Select Committee on Company Law, from Marie Corbett, LL.B.
51. Presentation to the Ontario Select Committee on Company Law, by Mr. Murray Thompson, Q.C., Superintendent of Insurance, January 22, 1980.
52. RRSP Advertising Guidelines, adopted by various financial institutions doing business in Ontario.
53. Canadian Life Insurance Association, Response to Presentation by the U.S. Federal Trade Commission and Others, February 11, 1980.

## LIST OF SELECTED REFERENCE MATERIAL

This is a partial listing of some of the material made available to the Committee during its investigations into life insurance. Many other articles and publications were also reviewed by the Committee and its consultants. This material is *not* available in the Legislative Library.

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———, Report of the Standing Committee on General Insurance Legislation, July 16, 1979, M. A. Thompson, Q.C., Chairman.

———, Report of the Standing Committee on Insurance Agents, Brokers and Adjusters, August 26, 1979, Scott G. Harvey, Chairman.

———, Report of the Standing Committee on Life Insurance Legislation, September 18, 1979, Earl M. Saunderson, Chairman.

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- \_\_\_\_\_, Letter of December 7, 1979 to R. P. Boddy from J. E. MacNaughton, re: additional material for Ontario Select Committee on Company Law.
- \_\_\_\_\_, Letter of February 26, 1980 to R. P. Boddy from W. T. Morgan re: experiment in Quebec with regard to agents' training.
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- c) Booklets: *The Automated MIB* and *The History of the Automated MIB System*
- d) Statement regarding MIB's Security Program
- e) MIB "Request for Disclosure" (Form D2); sample letter of disclosure, sample disclosure instructions to reporting company; disclosure confirmation
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## APPENDIX C

(referred to in Chapter 5)

### **LIFE-RRIF: A SOLUTION TO THE PROBLEM OF PENSION INDEXING**

**by C. Kapsalis, Economic Council of Canada\***

Are you concerned that inflation will erode the purchasing power of your RRSP during retirement? Well, the Federal Government has recently introduced a plan that contains the seeds of the solution to the problem. The new plan is called Registered Retirement Income Fund—RRIF for short.

To be sure, the present design of the RRIF plan will be found unattractive by most Canadians. However, I will demonstrate in this paper that the federal scheme can be vastly improved by introducing a life insurance component into it. The new scheme, which I have named LIFE-RRIF, may well turn out to be the most attractive option to an RRSP holder. It may also appeal to employer-sponsored pension plans.

#### *Before RRIF*

Until now, if you were contributing to an RRSP, you had only two options at retirement:

- Withdraw the full amount of the RRSP and become liable to pay income tax on it in the same year—a very unattractive proposition.
- Purchase a life annuity from an insurance company and pay taxes as you receive benefits.

The problem with conventional life annuities, however, is that the value of benefits is fixed in nominal terms. As a result, inflation is eating into the purchasing power of benefits. Thus, for example, at an annual rate of inflation of 8 percent, your benefits will be worth only half as much nine years after retirement.

In fact, the inability of the insurance industry to introduce annuities that are indexed to the cost of living, is perhaps the most critical issue facing private pension plans today. Without going into much detail, it is worth mentioning that the overwhelming majority of observers have concluded that indexing of private pensions would require some form of government involvement: indexed bonds, an inflation insurance scheme,<sup>1</sup> replacement of employer-sponsored plans by a public plan.

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### *The RRIF Proposal*

The RRIF has introduced an alternative way of coping with inflation that does not resort to government involvement.

The main attraction of an RRIF is that payments grow from year to year at the rate of return on investment in the fund (see column 4 of the Table). Thus, to the extent that the rates of return reflect price increases, this will tend to protect the real value of the benefits over time. Indeed, if the rates of return exceed the rate of inflation, this will enable the pensioner to improve his real standard of living along with other Canadians.

What is an RRIF? It is an investment fund that may be comprised of a wide variety of qualified investments: stocks, bonds, bank certificates, savings bonds, mutual funds. As in the case of an RRSP, an RRIF owner will be allowed to manage his own investments through directions to the trust company holding his fund. An RRIF is similar in many respects to an RRSP. In fact, an RRIF is a logical extension into the retirement years of an RRSP.

How does an RRIF work? A certain fraction of the total assets in the fund—capital plus accumulated earnings—is withdrawn each year by the holder to provide annual income to the age of 90. The fraction is related to the age of the recipient and is simply equal to one divided by the number of years remaining to age 90 (see column 2 of the Table).

However, the present RRIF formula is subject to a major limitation: calculations are made assuming that a person will live to be 90.

There are two problems with the age 90 assumption:

- First, if you live beyond the age 90, although the probability is small, you will be left with no income from RRIF.
- Second, and more significant, if you retire at the age of 70 and you are male, you are expected to live slightly less than 11 years. This means that, if you are the average male Canadian, 40 percent of the value of your RRIF will go to your estate. And if you are rich, there is no problem. Most likely, you will leave an estate behind you anyway. But what if you are the average pensioner who can hardly make ends meet?

Most Canadians will find unattractive a retirement income plan that leaves 40 percent of the pensioner's savings to his estate. The present design of the RRIF formula is, therefore, unacceptable.

### *The LIFE-RRIF Proposal*

There is, though, a straightforward solution to the problem. The solution calls for the integration of life expectancies into the RRIF formula.

What does the new scheme, which I have named LIFE-RRIF, look like? It is similar to the RRIF scheme subject to three major modifications:

- The age of 90 is replaced by the life expectancy of the individual (e.g. 80 in the case of our example—see Table).
- Benefits increase annually at the rate of return of investments, as under an RRIF. However, benefits now continue to grow and be paid until the pensioner dies.
- The balance that may be left behind by a pensioner does not go to his estate, but to the insurance company.

It can be easily shown that the balance left behind by those who die early is just enough to pay for the benefits of those who die late.<sup>1</sup>

The payment stream of a LIFE-RRIF is much higher than that of an RRIF. In our example, it is 40 percent higher. This is not surprising since under an RRIF the holder is expected to leave to his estate 40 percent of the assets. Under a LIFE-RRIF everything goes to the pensioners themselves.

The present value of the payment stream of a LIFE-RRIF is equal to that of a life annuity. However, by starting from a lower level of payments, a LIFE-RRIF maintains a more stable stream of real benefits than an annuity.

### *Conclusion*

From the pensioner's point of view, a LIFE-RRIF is clearly superior to an RRIF or a life annuity. There are two additional considerations, however, that may further enhance the attractiveness of my proposal.

First, from the insurance industry's point of view, a LIFE-RRIF is more attractive than life annuities. This is because in the case of a LIFE-RRIF the rate of return paid to the holder is the realized one and, therefore, there is no uncertainty involved.

Second, from the macro-economic point of view, indexing pensions to the rate of return on investment, through a LIFE-RRIF, is less inflationary than indexing to the cost of living.

In conclusion, I believe that a LIFE-RRIF is a very desirable vehicle for investing retirement savings. It deserves serious consideration by the government and the insurance industry.

1. Let us use the example in the Table to show the validity of this statement. According to the life expectancy, the last payment to the average male who retires at the age of 70 would be made at the age of 80. Suppose there are two males, each with a fund of \$1,000. The first dies at the age of 78 (so he misses two years of expected payments). The second dies at the age of 82 (so he collects for two more years than anticipated). The first person leaves behind him a balance of \$336.51. Three years later the balance is worth \$423.91 (rate of return 8%). Minus \$211.97 to the surviving individual, leaves a balance of \$211.97. The following year the balance is worth \$228.92, which is just enough to pay the last benefit to the surviving individual.

# APPENDIX C

TABLE 1  
COMPARISON OF PAYMENTS UNDER A LIFE ANNUITY, AN RRIF, AND A LIFE-RRIF FOR EACH  
\$1,000 INVESTMENT BY AN INDIVIDUAL AT AGE 70 (8% RATE OF RETURN)

Age of Individual on Jan. 1	Life Annuity Payments (1)	RRIF		LIFE RRIF			
		Fraction of Assets Paid (2)	Balance at Start of Year (3)	Annual Payments (4)	Fraction of Assets Paid (5)	Balance at Start of Year (6)	Annual Payments (7)
70	\$140.08	1/20	\$1,000.00	\$ 50.00	1/11	\$1,000.00	\$ 90.91
71	140.08	1/19	1,026.00	54.00	1/10	981.82	98.19
72	140.08	1/18	1,049.76	58.32	1/9	954.32	106.04
73	140.08	1/17	1,070.76	62.99	1/8	916.14	114.52
74	140.08	1/16	1,088.39	68.02	1/7	865.75	123.68
75	140.08	1/15	1,102.00	73.47	1/6	801.43	133.58
76	140.08	1/14	1,110.81	79.34	1/5	721.28	144.26
77	140.08	1/13	1,113.99	85.69	1/4	623.18	155.80
78	140.08	1/12	1,110.56	92.55	1/3	504.78	168.27
79	140.08	1/11	1,099.45	99.95	1/2	363.43	181.73
80	140.08	1/10	1,079.46	107.95	1	196.27	196.27
81	140.08	1/9	1,049.24	116.58	—	—	211.97
82	140.08	1/8	1,007.27	125.91	—	—	228.92
83	140.08	1/7	951.87	135.98	—	—	247.24
84	140.08	1/6	881.16	146.86	—	—	267.02
85	140.08	1/5	793.04	158.61	—	—	288.38
86	140.08	1/4	685.19	171.30	—	—	311.45
87	140.08	1/3	555.00	185.00	—	—	336.37
88	140.08	1/2	399.60	199.80	—	—	363.27
89	140.08	1	215.79	215.79	—	—	392.34
90	140.08	—	0	0	—	—	423.72
91	140.08	—	0	0	—	—	457.62
92	140.08	—	0	0	—	—	494.23

Note: It is assumed that payments are made at the beginning of the year, that simple interest is credited at year end, and that no change occurs in the market value of the investments (these assumptions are identical to those of the Budget).

It is also assumed that the taxpayer is a male with a life expectancy of 11 years. This means that he receives his last payment at the age of 80.

## APPENDIX D

(referred to in Chapter 5)

### **GUIDELINES FOR THE ADVERTISING OF REGISTERED RETIREMENT SAVINGS PLANS (R.R.S.P.s) IN ONTARIO**

#### **PREAMBLE**

Companies offering Registered Retirement Savings Plans recognize the public need for plain and comprehensible information about these plans. To that end, the principles that follow have been adopted as a guide, in intent and in spirit, for their printed and media R.R.S.P. communications.

#### **GUIDELINES**

1. These companies subscribe to The Canadian Code of Advertising Standards, as published by the Canadian Advertising Advisory Board, a copy of which is appended to and forms part of these guidelines.
2. The principle that R.R.S.P.s are vehicles for the accumulation of retirement income will be upheld.
3. Whenever tax saving is described as an advantage in printed material, it will be indicated that ultimately all benefits received must be added to income.
4. (a) Where guaranteed rates of return are advertised, the guaranteed interest rate payable will be prominently set out. There also may be presented:
  - (i) the compound annual rate of return where the reinvestment of income is guaranteed at the same guaranteed rate, or
  - (ii) the rate of return on reinvested income, if different from the guaranteed rate, provided there is notice that such rate is subject to change.
- (b) Where other advertised rates of return are subject to change, this shall be so stated.
5. Where past performance is advertised, such as with investment or segregated funds, there will be prominently set out as a minimum:
  - (i) the compound annual rate of return for the twelve month period ending not earlier than three months prior to first publication of the advertisement together with the cumulative compound rate of return for a period not less than five years or such shorter period not less than one year as the fund has been available for



R.R.S.P.s, ending at the same date as the aforementioned twelve month period, and

- (ii) the date at which the periods used in calculations of compound annual or cumulative compound rate of return end or begin.
6. Whenever a rate of return is advertised, it will be accompanied by a description of the basis for its calculation including the frequency of income (interest) payment and, if income (interest) is compounded, the frequency of compounding.
  7. (a) Where rates of return are advertised in printed material in respect of investments for stipulated periods of time, there also shall be indicated any qualification which would prevent redemption prior to the expiry of such period.  
(b) Where redemption privileges for investments are provided, any qualifications preventing redemption within sixty days from the date of the receipt of the annuitant's redemption request by the offering company shall be indicated in printed material.
  8. Where fees are referred to in printed material, a statement shall be included of all administrative fees or other charges which are applicable.
  9. All companies will have available, in written form, full details of the terms and conditions governing the R.R.S.P. and, where applicable, the investments to be made thereunder, which will be delivered to the annuitant or receipt of which the prospective annuitant will be required to acknowledge on the application form. Included in the written material, will be a description of all charges entailed in the purchase, maintenance, surrender (redemption) or transfer of an R.R.S.P. or an asset thereof.

December 5, 1979

Canadian Life Insurance Association.

## APPENDIX E

(referred to in Chapter 7)

### SELECTED LIFE INSURANCE INDUSTRY UNDERWRITING PRACTICES

The life insurance industry underwriting practices illustrated in this Appendix are selected from the underwriting manuals of a number of major insurers writing in Ontario. The listings that make up this Appendix do not reflect entirely the underwriting practices of any insurer nor do they necessarily include practices common to all insurers surveyed. They are as well only partial lists, of selected practices.

#### A. MEDICAL RATINGS

This is a selected, very abbreviated list of some medical conditions found to be included in company underwriting manuals as cases where a basic life insurance policy would be issued at substandard premium rates. Many of these medical conditions were selected as examples of cases where the relationship to early mortality may not be readily evident to a layman.

Amputations (other than fingers or toes)  
Arthritis (degenerative, rheumatoid, etc.)  
Bursitis  
Recurrent dislocations  
Fractures (including simple)  
Gout  
Osteogenesis Imperfecta (brittle bones)  
Rheumatism  
Rickets  
Overweight, underweight  
Build abnormal (dwarfism, giantism)  
Premature infants  
Deafness  
Deaf mutism  
Blindness  
Cataract  
Glaucoma  
Pupillary Abnormality  
Retinitis  
Strabismus (squint, cross eyes)  
Diabetes  
Insanity  
Tuberculosis (co-resident or association)  
Temperature abnormal

Appearance unsatisfactory (unusual ageing)  
Cleft palate  
Crippling disablement, lameness, limp  
Ulcer  
Skin disorders (acne, athlete's foot, etc.)  
Spinal deformity  
Benign Tumors (cyst)  
Amnesia  
Mentality subnormal  
Mongolism  
Convulsions (epilepsy)  
Paralysis  
Concussion  
Headache  
Insomnia  
Reflexes abnormal  
Sunstroke  
Psychosis (insanity)  
Suicide attempt  
Hypertension  
Asthma  
Bronchiectasis  
Bronchitis  
Chest deformity  
Emphysema  
Lungs unsatisfactory (shape, sounds)  
Nasal impairment  
Appendicitis  
Food poisoning  
Breast implants  
Pregnancy  
Testicular atrophy, enlargement, excision  
Epilepsy  
Fainting  
Indigestion  
Oophorectomy  
Nervous breakdown  
Cigarette smoking

### *Notes*

1. If the basic insurance is to be issued at standard rates there are only a small number of cases where a waiver of premium or accidental death benefit rider will not also be issued at standard rates. The exceptions include, in some cases, blindness due to injury, deaf mutism, deteriorating disc and dormant epilepsy.

2. If the basic insurance is issued with a moderate rating, the waiver of premium and accidental death benefit riders will also be rated in most cases. Rare exceptions may include certain ulcers, hiatus hernias, and kidney stones.
3. If the basic insurance is severely rated or declined, waiver of premium and accidental death benefit riders will not be made available.

## B. AVOCATIONAL RATINGS

The following listing provides examples of persons with avocations who would be rated by some life insurance companies:

Automobile racers  
 Balloonists  
 Bobsled racers  
 Divers  
 Hand gliders  
 Motor boat racers  
 Motorcycle racers  
 Mountain climbers  
 Rodeo participants  
 Skiers  
 Sky divers  
 Snowmobile racers

## C. OCCUPATIONAL RATINGS

The following occupations have been found to be rated (R), declined (D) or reserved for individual consideration (IC) for basic insurance and for waiver of premium and accidental death benefit riders. The list that follows is only a partial list and does not reflect all occupations rated as substandard by insurers writing in this Province.

	Basic Insurance	Waiver of Premium	Accidental Death
Abrasive industry (clay, stone, etc.) workers	R	R	R
Air traffic controllers		R	
Athletes	R	D	D
Asbestos products manufacture workers		R	D
Asphalt workers	R	R	R
Atomic energy workers		IC	
Automobile sales and services personnel		R	R
Battery manufacture workers	R	R	
Boiler workers		R	R
Bookmakers	R	D	D
Brick, tile manufacture workers		R	R
Building and construction workers	R	R	R
Building demolition workers	R	R	R



Building movers, wreckers	R	R	R
Building services workers	R	D	D
Bridge, dam, lock construction workers	R	R	R
Caisson workers	R	D	D
Chimney and smokestack workers	R	D	D
Shaft, tunnel construction workers	R	D	D
Cement, gypsum workers		R	R
Chauffeurs and drivers	R	D	D
Chemical industry workers (lead tetraethyl workmen, etc.)	R	R	R
Chimney sweeps		R	R
Coal, coke and wood distributing personnel		R	R
Dock workers	R	R	R
Electrical industry workers		R	R
Enamelling factory workers	R	R	R
Explosives and munitions manufacture workers	R	R	R
Manufacture of small arms ammunition, etc. workers	R	R	D
Exterminators and fumigators		R	R
Fire Department employees			R
Fishermen	R	R	R
Food processing industries workers		R	R
Fur industry (hunters and trappers) people	IC	IC	IC
Garbage collectors		R	R
Glass manufacture workers		R	R
Horse racing personnel	R	D	D
Hotels, clubs, restaurants employees	R	R	
Ice industry workers		R	R
Insecticide manufacturing workers	R	R	R
Junk dealers		R	R
Labourers		R	R
Leathergoods workers		R	R
Liquor industry workers		R	R
Lumber industry (rangers, logging, mills) workers	R	R	R
Marine industry, vessel workers			R
Match manufacture employees		R	R
Metal industry workers (smelter, refinery, machine shops)		R	R
Mining employees (geologists, prospectors, underground workers, surface workers, crushing workers, other workers)	R	R	R
Neon light sign workers			R
Oil and natural gas industry (exploration, drill operations) employees	R	R	R
Oil refinery workers	R	R	R
Paint, white lead manufacture industry employees		R	R
Painters and varnishers	R	D	D
Paper and pulp industry workers		R	R
Police		R	R
Prison employees			R
Pottery industry workers	R	R	R
Racketeers and illegal professional gamblers	D	D	D
Radium and uranium ore workers	R	R	R
Railroad employees		R	R
Rendering plant workers	R	R	R
Roofing materials manufacture employees		R	R
Rubber industry employees		R	R
Salt and potash industry workers	R	R	R
Sewer cleaners, cesspool workmen		R	R
Shoeshine parlours staff		R	
Snake milkers	R	R	R
Stone industry workers	R	R	R
Street cleaners and sweepers		R	R

Telephone linemen			R
Turpentine industry workers	R	R	R
Watchmen			R

Notes

1. If the basic insurance is to be issued at standard rates, in the majority of cases waiver of premium or accidental death benefits are issued as standard but there are also many cases where they will be rated.
2. If the basic insurance is issued with a moderate rating, the waiver of premium and the accidental death rider will also be rated except in a few rare exceptions, including sandblasters.
3. Where the basic insurance is severely rated or declined, waiver of premium and accidental death riders will be declined.

D. OTHER RATING CONSIDERATIONS

Information in the following areas may be requested from the applicant or through the agent's evaluation for underwriting consideration:

- Extent of foreign travel
- Non-medical use of drugs
- Receiving welfare
- Illegal activities (criminal record)
- Financial status
- Home environment
- Use of alcohol
- Morals or character evaluation
- Previous rejection for life insurance
- Family medical history
- Literacy in English or French



## APPENDIX F

(referred to in Chapter 7)

### SUMMARY OF ALBERTA HUMAN RIGHTS COMMISSION REPORT OF BOARD OF ENQUIRY<sup>1</sup>

IN THE MATTER of the Complaint filed by Ms. Penny Ann Cairns,  
Complainant, against the Great West Life Assurance Company Ltd.,  
Respondent

*December 29, 1978*

#### *The Complaint*

“There was a complaint filed by Miss Penny Ann Cairns against the Great West Life Assurance Company. In 1974 there was a discussion between Miss Cairns and an agent of the Great West Life Assurance Company concerning a retirement annuity. The annuity which was available to Miss Cairns was projected at \$374.13 per month. If Miss Cairns had been a male, the projected annuity would have been \$420.50 per month.”

#### *The Question Raised*

The question raised was whether there had been a contravention of Section 2 of The Individual's Rights Protection Act, which reads as follows:

“No person, directly or indirectly, alone or with another, by himself or by the interposition of another shall:

- (a) deny to any person or any class of persons any accommodation, services or facilities customarily available to the public, or
- (b) discriminate against any person or class of persons with respect to any accommodation, services or facilities customarily available to the public,

because of the race, religious beliefs, colour, sex, ancestry or place of origin of that person or of any other person or class of person.”

#### *The Board's Considerations*

In each of five cases, four concerning automobile insurance and one, Miss Cairns case, concerning life insurance, the Board was required to consider:

1. The Board of Enquiry of the Alberta Human Rights Commission issued its Report of December 29, 1978 in the matter of five complainants who alleged discrimination on the basis of their sex contrary to the provisions of Alberta legislation. The five cases were not identical but had many common features. Four of the five complaints, that is excluding the complaint filed by Ms. Cairns, concerned automobile insurance.



1. Whether the company discriminated against the person making the complaints;
2. Whether the discrimination was because of the sex of that person;
3. Whether that discrimination was with respect to services; or
4. Whether the services were customarily available to the public.

Excerpts of the Board's comments under each of the above matters follow.

### **1. Whether the Company Discriminated Against the Person Making the Complaint**

"It is clear that in each case the company made a distinction between the complainant and a member of the opposite sex. With respect to each of the cases involving automobile insurance, the result of the distinction for the complainant was a higher premium for automobile insurance, quoted or charged. With respect to the complaint of Miss Cairns, the result of that distinction was a lower monthly retirement annuity for her. In each case, therefore, the distinction was adverse. Nothing further is required to constitute discrimination against a person.

Therefore in answer to question 1 above, "Whether the company discriminated against the person making the complaint", we find that in each case there was, within the dictionary and judicial definitions quoted, discrimination against the person making the complaint."

### **2. Whether the Discrimination was Because of the Sex of that Person**

The Commission referred to the automobile insurance cases before it in outlining its reasoning on this matter, concluding that the same reasoning applied to the life insurance case under consideration.

"It was strongly urged before us that these classifications, which have been accepted by the Alberta Automobile Insurance Board, do not constitute discrimination because of sex. It was argued that if there was discrimination, it was discrimination because of driving experience, which is not prohibited by the Individual's Rights Protection Act.

It is clear, however, that other things being equal, the risk record attributed to a man or woman applying for insurance coverage is not the individual record of the applicant, but is the actuarial experience of a man or woman, as a typical member of a class; the class being determined by the sex of the applicant. In other words, the actuarial experience of a class is assigned to an applicant because of the applicant's sex, not because of the applicant's personal driving record.

There is no test other than the sex of the applicant used to attribute to the applicant a risk classification, all other things being equal.

In our view, the decision of the respondent in each of the automobile casualty insurance cases before us attributed characteristics to each complainant, not based on that person's individual driving record, but arising from the driving experience of male drivers generally. Therefore, each was charged or would have been charged a premium greater than a female of similar individual characteristics."

"We are therefore of the view that in each case the company has discriminated against the complainant because of sex.

The same reasoning has caused us to reject the argument that Great West did not discriminate against Miss Cairns because of her sex, but because women as a class live longer than men as a class."

### **3. Whether that Discrimination was with Respect to Services**

"The activities of the companies complained of clearly fall within the dictionary definition of "services" and the authorities do not indicate that this word should be given a different meaning in Section 3(b) of The Individual's Rights Protection Act.

Therefore, we find that each of the companies complained of rendered services."

### **4. Whether the Services were Customarily Available to the Public**

"The Cairns case concerned the purchase of an annuity. An annuity contract is one whereby, in consideration of a single payment or periodic payments by the annuitant, the insurer agrees that at a fixed time, it will require no further payments and will commence paying the annuitant for life, periodic sums of money as described in the annuity policy.

The insurer accepts the payment or periodic payments from the annuitant. It manages these funds in a responsible manner so that funds will be available to the insurer many years in the future for the satisfaction of its undertaking to make the agreed periodic payments to the annuitant. We find this to be a service, within the definition referred to above.

The evidence indicated that the companies offering annuity contracts leave it to individual members of the public to determine who will or will not apply for an annuity contract. The insurer considers only age and sex in determining the payment or payments to be made. No one is refused.

For these reasons we find that in the Cairns case, Great West Life was offering a service customarily available to the public."

### *Recommendation Regarding Priority of Laws*

"We have found that in the case before us, there was discrimination under The Individual's Rights Protection Act. That Act is to be construed as

paramount where authority under another statute conflicts with it and no express exemption is stipulated in the other statute.

Although indirectly, through the authority and practices of The Alberta Insurance Board, the Alberta Insurance Act encourages and perpetuates the insurance industry classification system giving rise to the discrimination we found. There is no provision in The Alberta Insurance Act to exempt its provisions from the conduct stipulated in The Individual's Rights Protection Act as discriminatory. Some evidence was presented before us concerning the adverse impact on the insurance industry if it were prevented from using the classifications leading to the prohibited discrimination. This evidence was not sufficient to enable an adequate evaluation to be made of the impact on the insurance industry, nor were our terms of reference sufficient to constitute this Board the appropriate forum for hearing such evidence.

We are therefore not in possession of sufficient factual information to recommend that an exemption ought to be inserted in The Alberta Insurance Act insofar as the applicant of The Individual's Rights Protection Act is concerned.

However, we very strongly recommend that steps be taken by the appropriate department of government to hold a hearing before qualified persons that will enable interested parties to present sufficient information to enable such a decision to be made. Failing the passage of an amendment to exempt The Alberta Insurance Act, the classification system applied by the insurance industry in cases similar to those before us leads to discrimination under The Individual's Rights Protection Act, and a prohibition against continuing the use of those classifications ought to be sought."

## APPENDIX G

(referred to in Chapter 8)

### THE CANADIAN LIFE INSURANCE ASSOCIATION—GUIDELINES WITH RESPECT TO THE INTEREST-ADJUSTED COST INDEX—JUNE 1979

“Set out below are certain considerations and standards concerning the recommendation that member companies should provide the interest-adjusted cost index on request\* to policyholders or prospects. It is further recommended that companies should provide indices using a 5 percent rate of interest and as a minimum, 10-year and 20-year durations, along with an appropriate explanation of the limitations of indices.

#### *RATE OF INTEREST*

Regarding the 5% rate of interest, the Joint A.L.C.-L.I.A.A. Committee on Cost Comparisons (the so-called Moorhead Committee) said that “a reasonable choice for general use is a rate close to the after-tax rate readily obtainable over a period of years on accounts in savings institutions” and also that “the selected rate must be reasonable for savings made gradually over a considerable period”. The rate being used in the United States is 4%. In view of current and prospective interest levels in Canada and the desirability of a differential between United States and Canadian rates for the index calculation, a 5 percent rate seems appropriate.

*Note:* The recommended rate was changed to 6 percent in November 1977.

#### *Illustration Period*

It is felt that both a 10-year and 20-year index figure should be provided. This suggestion is consistent with both the Model Regulation developed for the N.A.I.C. and the Moorhead Report.

Companies can provide figures for additional periods if they wish.

#### *Calculation Formula*

The calculation procedure is described in the Association booklet “How to Compare—Considerations in the Comparison of Life Insurance Policies” issued in September 1976.\*\*

\* Provision “on request” is consistent with the positions of the American Life Insurance Association and the National Association of Insurance Commissioners. It was suggested by the N.A.I.C., however, that those states which so desire can require that the index be provided in all cases rather than on request.

\*\* A third edition issued in July 1978 contains interest adjusted indices calculated at an interest rate of 6%.



In applying the formula set forth in the booklet, it is noted that, in lieu of calculating the value of their accumulated dividends at 5 percent, some companies may wish to use the corresponding cash values of their paid-up insurance additions.

### *Supplementary Benefits, Sub-Standard, Etc.*

Index figures should be expressed per \$1,000 of insurance for the amount of the policy being offered and should exclude benefits supplementary to basic insurance benefits.

The N.A.I.C. Model Regulation referred to above does not require the delivery of indices for life insurance issued on sub-standard risks and a similar approach is recommended for Canada.

### *Limitations of Interest-Adjusted Cost Index*

Warnings concerning the limitations of the interest-adjusted cost index should invariably accompany it. The following material may be adaptable for this purpose:

- The following index is called “an interest-adjusted cost index”. It is offered, for the sex and insurance age shown, as a simple guide to the cost of the life insurance contract to which it refers.
- It may be of some assistance to you in comparing the cost of similar policies issued by different insurance companies. However, it is likely to be misleading if used to compare significantly different policies, such as policies for different amounts of insurance, or issued at a different age, or for different plans of insurance.

### *(Insert Indices)*

- The indices are based on the assumption that the policy will be surrendered at a particular time, after ten years or twenty years. In fact, the index may be quite misleading under other circumstances because the guaranteed cash value significantly influences the index.
- Indices do not reveal the pattern of benefits under a policy. For example, one company’s policy may have a fairly high level of guaranteed cash values throughout a 20-year period while another company’s policy may start with low values in the early years and then have them increase sharply.
- Indices fail to compare many of the features of different companies such as service to be rendered in connection with the policy and also the strength of the company.
- In the case of participating insurance (which pays policy dividends), the

indices assume the company's current scale of policy dividends will continue. In fact, a company's current dividend scale is based on its current earnings and is not a guarantee or even an estimate of what will be paid in the future. That will depend upon the company's future earnings.

- How likely is it that future policy dividends will follow a company's current scale? This is difficult to judge. You could compare the dividend scale used when a policy was issued some years ago and the dividends actually paid after that. Such information for a particular policy of a company may be obtained from its representative. Dividend history information is also published in *Stone & Cox Life Insurance Tables*. An index is not a satisfactory substitute for a year-by-year display of cash values and policy dividends.
- For additional information on cost indices, write for the free booklet "How to Compare—Considerations in the Comparison of Life Insurance Policies" available from The Canadian Life Insurance Association, 55 University Avenue, Toronto, Ontario. M5J 2K7."



## APPENDIX H

(referred to in Chapter 8)

### THE CANADIAN LIFE INSURANCE ASSOCIATION—GUIDELINES WITH RESPECT TO ILLUSTRATIONS OF NON-GUARANTEED BENEFITS—JUNE 1979

#### “FOREWORD

On July 6, 1977, the Committee on Consumer Relations drew attention to problems associated with the illustration of non-guaranteed benefits: the public's difficulty in understanding the true nature of a dividend on an insurance policy, confusing it with a dividend on an investment; the widespread incorrect belief that a current dividend scale illustration is actually a prediction of future dividends; in connection with unguaranteed values under single premium or flexible premium insurance or deferred annuity plans, misunderstandings (i) as to the nature of any guarantees regarding values, (ii) as to the amount of premium to which any interest credits apply, (iii) as to the way in which interest credits apply, and (iv) as to surrender charges, if any; and the practice of quoting annuity income, based on current rates, obtainable from a lump sum available many years hence leading to unrealistic expectations. Accordingly, Council adopted the following:

#### *Non-Guaranteed Benefits—Guidelines for Disclaimer Clauses and New Money Policy Illustrations*

1. To overcome some of the confusion of dividends on insurance and annuity policies versus those on stock investments, reference should be made to the principal elements such as investment earnings, expenses and mortality.
2. The fact that a dividend illustration is simply a display of a current scale and not an estimate of future payments should be highlighted.
3. The general effect on the dividend scale of a change in the pattern of a company's financial results should be described; because of the current economic climate, particular reference should be made to the likelihood of a decrease in scale, as well as an increase.
4. Companies should ensure that any item shown or given to a customer which contains figures for non-guaranteed benefits is based on the company's current scale and contains the appropriate disclaimer clause in as large a print as the figures shown.
5. When illustrating income, either the current annuity rates or the settlement option rates could be used. If current annuity rates are illustrated, reference should be made in the disclaimer clause that the income is



based on current rates and that there could be a decrease or an increase at the income commencement date.

6. If income figures from the cash value and accumulating dividends are illustrated, particular reference should be made to the likelihood of a decrease as well as an increase in the non-guaranteed portion of the income.
7. Illustrations for policies based on new money rates, such as illustrations of dividend scales and of non-guaranteed values under single premium or flexible premium insurance or annuity plans, should be based upon "reasonable" hypothetical rates of interest. A hypothetical rate in excess of 10% should not be used. If the hypothetical rate used exceeds 7½%, a second set of values should be shown based on a hypothetical rate not in excess of 5%. The current new money interest rate could be substituted for the hypothetical rate in any calculation in respect of the first premium payment for any period that, and under such conditions as, the rate is guaranteed to apply. Any minimum interest rate guaranteed in the contract could be substituted for the hypothetical rate in any calculation in respect of any payments or periods to which it is guaranteed to apply.
8. In connection with non-guaranteed values under single premium or flexible premium insurance or deferred annuity plans, any illustrations of values should:
  - i) clearly describe the non-guaranteed nature of any assumed accumulation interest rates;
  - ii) clearly describe any guaranteed accumulation interest rates, including whether they apply only to the principal invested or whether they apply also to the reinvested earnings thereon;
  - iii) clearly indicate the period or periods to which any guaranteed interest rates apply;
  - iv) clearly indicate whether assumed and guaranteed interest rates apply to the whole deposit or only a portion thereof;
  - v) where a portion of the deposit is deemed to be reinvested from time to time, clearly indicate how assumed interest rates or guaranteed interest rates apply to amounts deemed to be reinvested;
  - vi) clearly indicate whether the surrender value at any time equals the accumulated value shown, or if not, what the difference is.
9. The disclaimer clause should be as brief as possible, bearing in mind the necessity to have it complete.

### *Examples of Appropriate Disclaimer Clauses*

#### **(a) Life Insurance**

Dividends illustrated above are based on the company's current scale and are not to be construed as guarantees or estimates of dividends to be

paid in the future. Dividends depend on mortality experience, investment earnings, expenses and other factors and may be increased or decreased each year at the discretion of the company.

**(b) Annuities**

Dividends illustrated above are based on the company's current scale and are not to be construed as guarantees or estimates of dividends to be paid in the future. Dividends depend on investment earnings, expenses and other factors and may be increased or decreased each year at the discretion of the company.

**(c) Income Based on Current Annuity Rates Applied to a Future Lump Sum**

The income illustrated above is based on the company's current annuity rates and is not to be construed as a guarantee or an estimate of the income to be paid in the future. Annuity income will be determined and guaranteed on the basis of the annuity rates prevailing at the date the income commences. Annuity rates depend upon mortality, investment earnings, expenses and other factors anticipated at the time the income commences. Thus, the amount of income may be smaller or larger than illustrated.

**(d) Single Premium or Flexible Premium Insurance or Annuity Plans**

There are a great many possible wordings that may be used depending on the nature of the plan. Although a variety of wordings is acceptable, whatever wording is used should adhere to the guidelines."



## APPENDIX I

(referred to in Chapter 11)

### THE BUSINESS PRACTICES ACT, 1974

Section 2 of The Business Practices Act in Ontario lists a number of practices deemed to be unfair under that Act. Section 2 reads as follows.

#### *Unfair Practices*

2. For the purposes of this Act, the following shall be deemed to be unfair practices,
  - (a) a false, misleading or deceptive consumer representation including, but without limiting the generality of the foregoing,
    - (i) a representation that the goods or services have sponsorship, approval, performance characteristics, accessories, users, ingredients, benefits or quantities they do not have,
    - (ii) a representation that the person who is to supply the goods or services has sponsorship, approval, status, affiliation or connection he does not have,
    - (iii) a representation that the goods are of a particular standard, quality, grade, style or model, if they are not,
    - (iv) a representation that the goods are new, or unused, if they are not or are reconditioned or reclaimed, provided that the reasonable use of goods to enable the seller to service, prepare, test and deliver the goods for the purpose of sale shall not be deemed to make the goods used for the purposes of this subclause,
    - (v) a representation that the goods have been used to an extent that is materially different from the fact,
    - (vi) a representation that the goods or services are available for a reason that does not exist,
    - (vii) a representation that the goods or services have been supplied for a reason that does not exist,
    - (viii) a representation that the goods or services or any part thereof are available to the consumer when the person making the representation knows or ought to know they will not be supplied,
    - (ix) a representation that a service, part, replacement or repair is needed, if it is not,
    - (x) a representation that a specific price advantage exists, if it does not,
    - (xi) a representation that misrepresents the authority of the



- salesman, representative, employee or agent to negotiate the final terms of the proposed transaction,
- (xii) a representation that the proposed transaction involves or does not involve rights, remedies or obligations if the representation is false or misleading,
  - (xiii) a representation using exaggeration, innuendo or ambiguity as to a material fact or failing to state a material fact if such use or failure deceives or tends to deceive,
  - (xiv) a representation that misrepresents the purpose or intent of any solicitation of or any communications with a customer.
- (b) an unconscionable consumer representation made in respect of a particular transaction and in determining whether or not a consumer representation is unconscionable there may be taken into account that the person making the representation or his employer or principal knows or ought to know,
- (i) that the consumer is not reasonably able to protect his interests because of his physical infirmity, ignorance, illiteracy, inability to understand his language or an agreement or similar factors,
  - (ii) that the price grossly exceeds the price at which similar goods or services are readily available to like consumers,
  - (iii) that the consumer is unable to receive a substantial benefit from the subject-matter of the consumer representation,
  - (iv) that there is no reasonable probability of payment of the obligation in full of the consumer,
  - (v) that the proposed transaction is excessively one-sided in favour of someone other than the consumer,
  - (vi) that the terms or conditions of the proposed transactions are so adverse to the consumer as to be inequitable,
  - (vii) that he is making a misleading statement of opinion on which the consumer is likely to rely to his detriment,
  - (viii) that he is subjecting the consumer to undue pressure to enter into the transaction.
- (c) such other consumer representations under clause (a) as are prescribed by the regulations made in accordance with section 16. 1974, c. 131, s. 2.

## APPENDIX J

(referred to in Chapter 13)

### REPORT OF THE SUPERINTENDENT OF INSURANCE FOR CANADA—1978

#### INVESTMENTS OF LIFE INSURANCE COMPANIES

#### CANADIAN COMPANIES: INVESTMENT IN SHARES OF REAL ESTATE CORPORATIONS

As at December 31, 1978, fourteen Canadian life insurance companies had invested in the shares of real estate corporations pursuant to subsection 65(1) of the Canadian and British Insurance Companies Act and Life Insurance Investment (Special Shares) Regulations. These companies were:

	Proportion of Voting Stock Owned By Insurance Companies %
Alliance Mutual Life Insurance Company Les Immeubles Alliance, Limitee	75
The Canadian Life Assurance Company Adason Property Limited	100
The CLGB Property Co. Ltd. (a wholly owned subsidiary of Canada Life Assurance Company of Great Britain)	100
Sherway Centre Limited	100
Confederation Life Insurance Company Capilano Plaza (Edmonton) Ltd.	50
Courts of St. James Limited	100
Denman Place Investments Ltd.	100
Glenmore Gardens Apartments Ltd.	100
Inverstones del Rio, C.A.	36
Crown Life Insurance Company Coronet Properties Limited	100
The Dominion Life Assurance Canada Domlife Realty Limited	100
The Equitable Life Insurance Company of Canada 262695 Holdings Limited	100
The Excelsior Life Insurance Company Citrex Properties Incorporated	100
Cottonwood Corner Shopping Centre (a 90% owned subsidiary of Landex Properties Limited)	90
Landex Development Corporation (a wholly owned subsidiary of Landex Properties Limited)	100
Landex Properties Limited	50
Marex Properties Limited	50
Mount Batten Properties Limited	100
Family Life Assurance Company Family Life Realty Development Inc.	33

The Great West Life Assurance Company	
G.W.R.S. Development Ltd.	50
Place Bonaventure Inc.	100
Place Bonaventure (South) Inc. (a wholly owned subsidiary of Place Bonaventure Inc.)	100
River East Developments Limited	75
Torwest Properties Limited	50
Torwest Properties USA Limited (a wholly owned subsidiary of Torwest Properties Limited)	100
The Imperial Life Assurance Company of Canada	
Abercorn General Investments Limited (a 100% owned subsidiary of Castlemere Properties (Manchester) Ltd.)	100
Castlemere Properties Limited	73
Castlemere Properties (Manchester) Ltd.	50
Castlemere Properties (Northern) Limited	50
East Layne (Maidstone) Limited (a 100% owned subsidiary of Impco Properties (G.B.) Ltd.)	100
Imbrook Properties Limited	50
Impco Properties Limited	100
Impco Properties (G.B.) Limited	100
Invicta Investment Company Limited (a wholly owned subsidiary of Impco Properties (G.B.) Limited)	100
	100
London Life Insurance Company	
Duffwell Realities Limited	100
Leaside Towers Apartments Limited	50
Seachel Accommodations Ltd.	50
Toronto College Street Centre Ltd.	50
The Mutual Life Assurance Company of Canada	
Harmute Investments Limited	50
R.D.C. Property Services Limited	100
North American Life Assurance Company	
Crossroads Investments Ltd.	100
Edgecombe Properties Ltd.	100
Ennal Inc.	100
815 Hastings Investments Ltd.	100
Lambton Mall Limited	100
Naloy Properties Limited	100
Nalaco Realty Inc.	100
Townsite Park Apartments Ltd.	54
Williamsport Properties Limited	50
Sun Life Assurance Company of Canada	
Landridge Holdings Inc.	50
Panorama Apartments Ltd.	100
Panorama Apartments (Calgary) Limited	100
Pitt Street Developments Limited	45
Riverside Terrace (Ottawa) Limited	100
S. & M. Developments Ltd.	100
258256 Holdings Ltd.	50
279906 Ontario Limited	50
Tybrant Realty Limited	50

As the following table illustrates, the greater part of the financing of real estate development through real estate subsidiaries is by way of bonds and mortgage loans.

## TOTAL PAID CAPITAL AND LONG-TERM LIABILITIES OF REAL ESTATE CORPORATIONS

	Total \$	Portion of Total Owned by the Fourteen Life Insurance Companies \$
Preferred shares	23,019,765	13,719,034
Common shares	10,881,500	7,060,385
*Bonds	195,264,035	101,987,932
Mortgage loans	124,077,633	46,493,157
Total 1978	<u>353,242,933</u>	<u>169,260,508</u>
Total 1977	<u>297,903,388</u>	<u>140,772,295</u>

\* Includes notes payable and interim evidences of indebtedness.

## CANADIAN COMPANIES: INVESTMENT IN SHARES OF FOREIGN LIFE INSURANCE CORPORATIONS AND OTHER CORPORATIONS

In addition to the real estate corporations listed above, several Canadian life insurance companies and one fraternal benefit society, had invested in the shares of foreign life insurance corporations and other corporations pursuant to subsection 65(1) of the Canadian and British Insurance Companies Act and Life Companies Investment (Special Shares) Regulations. These companies were:

	Proportion of Voting Stock Owned By Insurance Companies %
<i>Foreign Life Insurance Corporations</i>	
The Canada Life Assurance Company	
Canada Life Assurance Company of Great Britain Limited	100
Canada Life Insurance Company of New York	100
Confederation Life Insurance Company	
Confederation Life Insurance Company (U.K.) Limited	100
La Confederation del Canada Venezolana, C.A.	34
Crown Life Insurance Company	
Crown Life Assurance Company Limited	100
Crown Life Pensions Limited	100
Crown Life (Caribbean) Limited	61
The Manufacturers Life Insurance Company	
Island Life Insurance Company Limited	99
The Manufacturers Life Insurance Company (U.K.) Limited	100
The Maritime Life Assurance Company	
Maritime Life (Caribbean) Limited	26
Sun Life Assurance Company of Canada	
Sun Life Assurance Company of Canada (U.K.) Limited	100
Sun Life Assurance Company of Canada (U.S.)	100
<i>Property and Casualty Insurance Corporations</i>	
Eaton/Bay Life Assurance Company	
Eaton/Bay Insurance Company	100



The Independent Order of Foresters	
Foresters Indemnity Company	100
The Northern Life Assurance Company of Canada	
The Personal Insurance Company of Canada	67

#### *Mutual Fund Corporations*

Confederation Life Insurance Company	
Confederation Funds Management Limited (a wholly owned subsidiary of	
Confederation Life Insurance Company (U.K.) Limited)	100
The North West Life Assurance Company of Canada	
NW Canadian Fund Ltd.	100
NW Equity Fund	100
NW Income Fund Limited	100

#### *Service Corporations*

The Canada Life Assurance Company	
Canada Life Unit Trust Managers Limited (a wholly owned subsidiary of Canada Life	
Assurance Company of Great Britain Limited)	100
The Manufacturers Life Insurance Company	
ManEquity Management Co.	100
ManEquity Inc. (a wholly owned subsidiary of ManEquity Management Co.)	100
Manulife Management Limited	100
The North West Life Assurance Company of Canada	
NW Fund Management Ltd.	100
Sun Life Assurance Company of Canada	
Suncan Equity Services Company	100

#### *Ancillary Business Corporations*

The Artisans, Life Insurance Cooperative Society Cogena Inc.	90
The Canada Life Assurance Company	
Canada Life Mortgage Services Ltd.	100
Canada Life Data Services Ltd.	100
Canada Life Investment Management Ltd.	100
CLASSCO Benefit Services Ltd.	100
Confederation Life Insurance Company	
Confed. Admin. Services Inc. (Delaware)	100
Confed. Admin. Services Inc. (Nevada) (a wholly owned subsidiary of Confed.	
Admin. Services Inc. (Delaware) )	100
Confed. Benefit Services Limited	100
Confed. Investment Management Limited	100
Confed. Investment Services Limited	100
Crown Life Insurance Company	
Crown Life Management Services Limited	100
Datacrown Limited (a wholly owned subsidiary of Niagnat Holdings Ltd.)	100
Niagnat Holdings Ltd.	90
Systems Dimensions Limited (a wholly owned subsidiary of Niagnat Holdings Ltd.)	100
The Excelsior Life Insurance Company	
Excelsior Financial Programs Limited	100
The Great West Life Assurance Company	
Harriot & Associates of Canada (1974) Limited	100
Vesma Services Incorporated	100
The Imperial Life Assurance Company of Canada	
Impco Health Screening Limited	100
London Life Insurance Company	
LONLIFE Data Services Ltd.	100
LONLIFE Financial Services Ltd.	100
Lonsdale Systems Limited (a wholly owned subsidiary of SDI Associates Ltd.)	100
SDI Associates Limited	100

The Manufacturers Life Insurance Company	
A/PCS Limited	100
Manulife Computer Corporation Ltd.	100
Manulife Investment Management Corp.	100
Manulife Services Corporation	100
The Mutual Life Assurance Company of Canada	
Mu Cana Data Services Ltd.	100
Mu Cana Investment Counselling Ltd.	100
North American Life Assurance Company	
Edgecombe Investment Services Limited	100
Edgecombe Investment Services (a wholly owned subsidiary of Edgecombe Investment Services Limited)	100
NALACO Investment Management Ltd.	100
Sun Life Assurance Company of Canada	
Sun Life of Canada Benefit Management Limited	100
Sun Life of Canada Investment Management Limited	100
Suncan Benefit Services Company	100







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